NOTES

EXTRATERRITORIAL EFFECT OF CONFISCATORY DECREES*

FOR twenty-two years, as a result of the spectacular Soviet nationalization program, the application of foreign confiscatory decrees to property held in this country has been argued and re-argued before American tribunals. At first the courts were mainly concerned with the non-recognition policy of the United States Government. But when in 1933 this policy was finally abandoned, they encountered a new difficulty: the interpretation of the combined effects of recognition and the simultaneously executed Litvinoff assignment.[1] By this instrument Soviet Russia assigned all her claims against American nationals to the Federal Government, as a prelude to a still uncompleted settlement of the debts owed American creditors by the Soviet.[2]

Although earlier litigation has raised the issues posed by recognition and the Litvinoff assignment,[3] the recent case of *The Moscow Fire Insurance Company v. Bank of New York and Trust Company*[4] is the first which has had a full trial on the merits. Several years after the property of the Moscow Fire Insurance Company had been confiscated by Soviet decree, its branch in New York was liquidated pursuant to the New York Insurance Law.[5] A portion of the securities on deposit with the Superintendent of Insurance, in accordance with regulations designed to protect domestic policy holders and creditors,[6] was used to pay these debts and to satisfy the attachment liens acquired by foreign or domestic creditors before liquidation. Retaining control of the remainder, the New York Court of Appeals invited the unpaid

* Moscow Fire Insurance Co. v. Bank of New York & Trust Co., 280 N. Y. 286, 20 N. E. (2d) 758 (1939).

1. For the complete text of these agreements, see (Supp. 1934) 28 AM. J. INT. L., Official Documents No. 1, pp. 1–11. For a history of the negotiations, see Sack, *Diplomatic Claims Against the Soviets (1918–1938)* (1938) 15 N. Y. U. L. Q. REV. 507, (1939) 16 N. Y. U. L. Q. REV. 253.

2. It is intended that funds recovered as a result of the Litvinoff assignment will be made available, in whole or in part, to American private claimants. See letter from the Department of State in brief for the Association of American Creditors of Russia as amicus curiae, pp. 8-9, Moscow Fire Ins. Co. v. Bank of New York & Trust Co., 280 N. Y. 286, 20 N. E. (2d) 758 (1939).

3. United States v. Belmont, 301 U. S. 324 (1937); Guaranty Trust Co. of New York v. United States, 304 U. S. 126 (1938); United States v. Manhattan Co., 276 N. Y. 396, 12 N. E. (2d) 518 (1938); Bettman v. Northern Ins. Co., 134 Ohio St. 341, 16 N. E. (2d) 472 (1938).

4. 280 N. Y. 286, 20 N. E. (2d) 758 (1939), *aff'g* 253 App. Div. 644, 3 N. Y. S. (2d) 653 (1st Dep't 1938); *aff'g* 161 Misc. 903, 294 N. Y. Supp. 648 (Sup. Ct. 1937), (1938) 13 ST. JOHN'S L. REV. 163, (1939) 88 U. OF PA. L. REV. 116.

5. N. Y. INS. LAW § 63.

6. N. Y. INS. LAW § 27.

creditors,[7] none of whom were American nationals, to file claims founded on business with the parent corporation in pre-Soviet Russia. While the determination of these issues was still pending, the United States announced its recognition policy. It then intervened in this action as assignee of the Soviet Government,[8] asserting that the Soviet had become the successor to the Moscow Fire Insurance Company's rights in the fund by virtue of the confiscatory decrees, which the American courts were now obliged to recognize as the mandates of a lawful sovereign.[9] The Court of Appeals, in an opinion by Judge Lehman to which three members dissented, rejected this argument and ordered that the distribution to foreign creditors and stockholders continue.

The decision is founded on the proposition that the Soviet Government had no rights in the fund, and therefore had nothing to assign.[10] In reaching this conclusion, Judge Lehman asserted that while extraterritorial application may have been intended for decrees nationalizing ordinary industrial and commercial property, no such intent either express or implied may be discovered in those separately issued confiscatory decrees which related to insurance businesses.[11] Furthermore, even if such an intent existed, it could not affect the title to local property. Particularly is this true of insurance companies, over which the state exercises extraordinary jurisdiction by virtue of its police power.[12] As a condition of doing business, in fact, securities must be deposited with the Superintendent of Insurance in an amount sufficient

7. Matter of People (Moscow Fire Ins. Co.), 255 N. Y. 415, 433, 175 N. E. 114, 120 (1931).

8. It had tried to institute a separate proceeding in the federal courts, but the latter could not disturb the state court's control of the fund awaiting distribution. United States v. Bank of New York & Trust Co., 296 U. S. 463 (1936). The chose in action which it gained by assignment arose only at recognition, when Soviet Russia gained the privilege to sue in American courts. Compare Russian Socialist Federated Soviet Republic v. Cibrario, 235 N. Y. 255, 139 N. E. 259 (1923) with Union of Socialist Soviet Republics v. National City Bank, 257 App. Div. 302, 13 N. Y. S. (2d) 236 (1st Dep't 1939).

9. Recognition operates retroactively, thus giving all previous decrees of the recognized government the character of law. Underhill v. Hernandez, 168 U. S. 250 (1897); see (1935) 20 MINN. L. REV. 95. Probably as the result of an erroneous obiter dictum in Oetjen v. Central Leather Co., 246 U. S. 297 (1918), this principle has been distorted into a doctrine that recognition "validates," *i.e.*, stamps with approval, all such laws retroactively. See Moore, *The New Isolation* (1933) 27 AM. J. INT. L. 607, 617. *Cf.* note 23 *infra*.

10. Under one interpretation, the Litvinoff assignment affected only claims owed by American nationals directly to the U. S. S. R. or its predecessor governments and did not cover claims that might be obtained through confiscation of the property of Russian nationals. The referee saw no validity in this contention. See Moscow Fire Ins. Co. v. Bank of New York & Trust Co., 161 Misc. 903, 910, 294 N. Y. Supp. 648, 660 (Sup. Ct. 1937). The Court of Appeals did not consider the question. But see United States v. Bank of New York & Trust Co., 10 F. Supp. 269 (S. D. N. Y. 1934).

11. Intervener's Exhibits 7, 11. Record in the principal case, pp. 1340, 1353. *Cf.* First Russian Ins. Co. v. London & Lancashire Ins. Co., [1928] Ch. Div. 922.

12. O'Gorman & Young v. Hartford Fire Ins. Co., 282 U. S. 251 (1931), 31 COL. L. REV. 498.

to constitute the "capital" of the branch office within the state "for all purposes."[13] Thus the branch is set up in New York as a "complete and separate organization."[14]

But Judge Lehman's argument that the assets of a branch insurance business are peculiarly subject to the laws of New York proves nothing in this case. The Superintendent of Insurance fulfilled his statutory obligation when he had satisfied the claims of domestic creditors and policy holders.[15] The New York courts have retained equitable jurisdiction over the remaining assets not because of any unique quality attaching to insurance funds, but merely because the surplus happens to remain on deposit in New York. If the parent company were liquidated at its domicile, these assets would be turned over to the foreign liquidator without question.[16] Although confiscation is not liquidation,[17] the surplus is none the less foreign property; the state has no right to these funds by escheat or otherwise.[18] Thus, while the "separate entity" concept might be relevant if the Soviet Government or its assignee were asserting rights in the original deposit, it is wholly unavailing in an action to recover the surplus.

An unspoken premise underlying the decision in the *Moscow* case may have been the settled conflict of laws rule that a sovereign has no power to legislate extraterritorially. Since foreign laws are given effect only on the principle of comity, rights existing under them are not enforced when repugnant to the "public policy" of the forum.[19] On this basis courts both here and abroad have in general denied the Soviet confiscatory decrees

13. N. Y. INS. LAW § 27. *Cf.* § 104 of the new Insurance Law, effective January 1, 1940.

14. Moscow Fire Ins. Co. v. Bank of New York & Trust Co., 280 N. Y. 286, 309, 20 N. E. (2d) 758, 767 (1939). *Cf.* Matter of People (Norske Lloyd Ins. Co.), 242 N. Y. 148, 159, 151 N. E. 159, 162 (1926); N. Y. INS. REPORT (1915) pt. I, 10.

The New York courts are not literal in their separate entity argument, as their alacrity in acknowledging the right of the foreign directors and stockholders to maintain suit well illustrates. Petrogradsky M. K. Bank v. National City Bank, 253 N. Y. 23, 170 N. E. 479 (1930) (before recognition); Vladikavkazsky Ry. v. New York Trust Co., 263 N. Y. 369, 189 N. E. 456 (1934) (after recognition). But *cf.* Russian Reins. Co. v. Stoddard, 240 N. Y. 149, 147 N. E. 703 (1925). The problem of allowing such suits has been the occasion for considerable excursion into theories of corporate existence. See the *Petrogradsky* case *supra;* Nebolsine, *The Recovery of the Foreign Assets of Nationalized Russian Corporations* (1930) 39 YALE L. J. 1130, 1147; Comment (1931) 15 MINN. L. REV. 210.

15. Matter of People (Russian Reins. Co.), 255 N. Y. 415, 175 N. E. 114 (1931).

16. Matter of People (Norske Lloyd Ins. Co.), 242 N. Y. 148, 151 N. E. 159 (1926); N. Y. CIV. PRAC. ACT § 977-b.

17. See James & Co. v. Second Russian Ins. Co., 239 N. Y. 248, 257, 146 N. E. 369, 371 (1925).

18. *Cf.* People v. O'Brien, 111 N. Y. 1, 18 N. E. 692 (1888).

19. RESTATEMENT, CONFLICT OF LAWS (1934) § 612; see Habicht, *The Application of Soviet Laws and the Exception of Public Order* (1927) 21 AM. J. INT. L. 238; Lorenzen, *Territoriality, Public Policy and the Conflict of Laws* (1924) 33 YALE L. J. 736; Comments (1936) 45 YALE L. J. 1463, 1467, *et seq.,* (1933) 33 COL. L. REV. 508.

extraterritorial effect;[20] the New York courts have traditionally so acted.[21] But the United States Supreme Court seems to have subscribed to another view in *United States v. Belmont*,[22] which also arose under the Litvinoff assignment. Mr. Justice Sutherland upbraided the American courts for flaunting "public policy" objections to the Soviet decrees, after the executive department had concluded a friendly agreement with the Soviet Government.[23] Judge Lehman, doubtless mindful of these strong remarks, men-

20. Borchard, *Confiscations: Extraterritorial and Domestic* (1937) 31 Am. J. Int. L. 675; Nebolsine, *supra* note 14. *Cf.* Lecouturier v. Rey, [1910] A. C. 262, Baglin v. Cusenier Co., 221 U. S. 580 (1911) (confiscation of property of Carthusian monks by France not accorded extraterritorial effect). But the validity of confiscation decrees has been upheld in regard to property within the territorial jurisdiction of the Soviet Government at the time of decrees, even though later removed. M. Salimoff & Co. v. Standard Oil Co., 262 N. Y. 220, 186 N. E. 679 (1933) (before recognition); Luther v. Sagor, [1921] 3 K. B. 532 (after recognition). *Cf.* The Navemar, 102 F. (2d) 444 (C. C. A. 2d, 1939). Also, in regard to contracts made within Soviet Russia. Dougherty v. Equitable Life Assur. Soc., 266 N. Y. 71, 193 N. E. 897 (1934). *Cf.* Holzer v. Deutsche Reichsbahn-Gesellschaft, 277 N. Y. 474, 14 N. E. (2d) 798 (1938). Consult Comment (1936) 13 N. Y. U. L. Q. Rev. 262, 448.

21. James & Co. v. Second Russian Ins. Co., 239 N. Y. 248, 146 N. E. 349 (1925) (before recognition); Vladikavkazsky Ry. v. New York Trust Co., 263 N. Y. 369, 189 N. E. 456 (1934) (after recognition); see Hudson, *Recognition of Foreign Governments and Its Effect on Private Rights* (1936) 1 Mo. L. Rev. 312, 319. For statutory indicia of the public policy of New York in the matter of confiscatory practices of foreign governments, see N. Y. Civ. Prac. Act § 977-b; *id.* §§ 474, 978, as amended by c. 672 of Laws of 1939; Surr. Ct. Act § 269, as amended by c. 343 of Laws of 1939. Notes appended to the 1939 amendments, *supra*, explain their purpose thus: "to authorize the deposit of moneys or property in the Surrogate's Court in cases where transmission or payment to a beneficiary, legatee or other person resident in a foreign country might be circumvented by confiscation in whole or in part." On this authority, the Surrogate's Court recently denied a request of the German consuls for the distributive shares of four German nationals of Jewish race. Matter of Weisberg, N. Y. L. J., Nov. 1, 1939, p. 1, cols. 3–5.

22. 301 U. S. 324 (1937). For a later history of the funds in issue in the *Belmont* case, follow Meyer v. Petrograd Metal Works, 11 N. Y. S. (2d) 125 (Sup. Ct. 1939).

23. Justice Sutherland's opinion raises an important question as to the meaning of recognition. The better view seems to be that it does not connote positive approval of acts of the recognized government. Borchard, *supra* note 20; Jessup, *The Litvinoff Assignment and the Belmont Case* (1937) 31 Am. J. Int. L. 481; J. F. Williams, *Recognition in International Law* (1934) 47 Harv. L. Rev. 776. It implies simply normalcy in relations. See Guaranty Trust Co. of New York v. United States, 304 U. S. 126, 140 (1938) ("the very purpose of the recognition by our Government is that our nationals may be conclusively advised with what government they may safely carry on business transactions and who its representatives are"); Dougherty v. Equitable Life Assur. Soc., 266 N. Y. 71, 84–85, 193 N. E. 897, 901 (1934). Conflict of laws rules alone should control both before and after recognition; recognition itself is wholly immaterial. Borchard, *The Unrecognized Government in American Courts* (1932) 26 Am. J. Int. L. 261. But where recognition is accompanied by some overt expression of sympathy, it would seem that a superior public policy has been determined by executive action, and state policies are irrelevant. See (1935) 35 Col. L. Rev. 292, 295. But see Guaranty Trust Co. of New York v. United States, *supra*, at 143.

tions "public policy" only to make specific rejection of the argument as a basis for the instant decision.[24] By thus camouflaging his fundamental objection, Judge Lehman may have hoped to conceal the divergence between his opinion and the advocacy by the *Belmont* case of unprejudiced enforcement of Soviet decrees as the solemn pronouncements of a lawful government. That he was probably conscious of this deviation is displayed by his insistence that the *Belmont* case decided only that the United States had a cause of action against a mere custodian of funds deposited in New York by a Russian company. Both majority and minority, he points out, issued an emphatic caveat that the decision did not preclude directors and stockholders of the Russian corporation from intervening in the action and entering their claims to the fund; latitude was thus expressly reserved for a decision in the situation now presented in the *Moscow* case.

Before giving content to any covert "public policy" objection, the New York court should have sifted the equities. If the court had recognized the Soviet Government as successor to the Moscow's residual right to property in New York by virtue of the confiscatory decree, the interests of American creditors would be unaffected, since their claims were satisfied out of the fund long before this action was instituted for the surplus. Losses would be sustained only by foreign creditors and stockholders, who may be said to have assumed that risk when they invested in a Russian corporation. Funds which are available only because of the single purpose of the New York legislature to provide security for the domestic creditors of a foreign company would come to them wholly gratuitously. It is therefore neither shocking nor fantastic that the United States should recover at their expense[25] and for the ultimate benefit of Americans who had invested in property in Soviet Russia.

One conclusion is inescapable. Although the majority opinion in the *Moscow* case is restrained and maintains at least superficial peace with the strong remarks in the *Belmont* case, it confirms a lack of enthusiasm for both the Soviet decrees and the Litvinoff assignment on the part of the New York courts, which handle most of the litigation in this field. If the Supreme Court should vote to affirm the decision in the *Moscow* case,[26] such a triumph would undoubtedly encourage American courts to parade "public policy" objections in defense of foreign victims of "un-American" confiscations abroad. Many dispossessed Austrian and Czechoslovakian nationals are now suing in New York courts to recover for goods sold and delivered before their businesses were appropriated by agents of the German Reich.[27] In

24. 280 N. Y. 286, 314, 20 N. E. (2d) 758, 769 (1939).

25. The question is frequently raised whether the United States violated the Fifth Amendment of the Constitution (*i.e.*, prohibition against taking of private property without just compensation) in accepting the Litvinoff assignment and thus joining in the confiscation of property located within this country. See Borchard, *supra* note 20; Jessup, *supra* note 23; Comment (1938) 5 U. OF CHI. L. REV. 280, 294-295; (1937) 47 YALE L. J. 292.

26. The Supreme Court has granted certiorari. (1939) 7 U. S. L. WEEK 421.

27. Stern v. S. S. Steiner, Inc., 12 N. Y. S. (2d) 44 (Sup. Ct. 1939); Johnson v. Briggs, 12 N. Y. S. (2d) 60 (Munic. Ct. 1939). Of current interest are effects of

these cases there will be much reliance on the precedents afforded by the long history of Soviet litigation. If the past is any index to the future, prediction may be made with some confidence that the recognition of the Anschluss, and the non-recognition of the seizures of Czechoslovakia and Poland, will prove immaterial.

JUDICIAL INTERCESSION IN INTERNAL AFFAIRS OF THE AMERICAN FEDERATION OF LABOR*

COURTS have consistently manifested an understandable reluctance to intercede in the internal affairs of non-profit associations.[1] The desire to remain aloof is most pronounced in the case of educational,[2] religious[3] or secret[4] societies, where a court which ventures to intervene finds itself faced with finely shaded distinctions in pedagogics, theology or mumbo-jumbo. Yet this desire is almost as strong with respect to all other non-profit organizations. It is based on the often inarticulate attitude that such groups by their very nature are better able than courts to solve typical controversies arising within them. Only when "fundamental" rights[5] are clearly violated or endangered will a court intercede. A surprising variant from previously settled conceptions was presented by a recent judicial readjustment of one of the oldest jurisdictional disputes within the American Federation of Labor.[6]

Mexican confiscatory decrees. *Cf.* Eastern States Petroleum Co. v. Asiatic Petroleum Corp., 28 F. Supp. 279 (S. D. N. Y. 1939).

*Joseph Obergfell *et al.* v. William Green *et al.*, 5 LAB. REL. REP. 163 (D. D. C. Oct. 6, 1939).

1. North Dakota v. North Central Ass'n of Colleges and Secondary Schools, 23 F. Supp. 694 (E. D. Ill. 1938); Harris v. Missouri P. Ry., 1 F. Supp. 946 (E. D. Ill. 1931); Long v. Baltimore & Ohio R. R., 155 Md. 265, 141 Atl. 504 (1928); Franklin v. Penn-Reading Seashore Lines, 122 N. J. Eq. 205, 193 Atl. 712 (Ch. 1937).

2. Anthony v. Syracuse University, 224 App. Div. 487, 231 N. Y. Supp. 435 (4th Dep't 1928); Barker v. Bryn Mawr College, 1 Pa. D. & C. 383 (C. P. 1921), *aff'd*, 278 Pa. 121, 122 Atl. 220 (1923).

3. Bonacum v. Harrington, 65 Neb. 831, 91 N. W. 889 (1902); Furmanski v. Iwanowski, 265 Pa. 1, 108 Atl. 27 (1919); *see* Watson v. Jones, 13 Wall. 679, 733 (U. S. 1871). *Contra:* Free Church of Scotland v. Overtoun [1904] A. C. 515.

4. Wellenvoss v. Grand Lodge Knights of Pythias of Kentucky, 103 Ky. 415, 45 S. W. 360 (1898).

5. *See* note 15 *infra.*

6. Obergfell v. Green, 5 LAB. REL. REP. 163 (D. D. C. Oct. 6, 1939); *see* (1939) 5 LAB. REL. REP. 117; N. Y. Times, Oct. 7, 1939, p. 10, col. 3. For a history of the dispute, *see* BROOKS, WHEN LABOR ORGANIZES (1st ed. 1937) 43; and SCHLÜTER, THE BREWING INDUSTRY AND THE BREWERY WORKERS' MOVEMENT IN AMERICA (1st ed. 1910) 226. Courts have previously declined to interfere with the AFL method of making or enforcing jurisdictional awards. California State Brewers' Institute v. International Brotherhood of Teamsters, Chauffeurs, Stablemen and Helpers, 19 F. Supp. 824 (N. D. Cal. 1937); Obergfell v. Green, 1 A LAB. REL. REP. 663 (D. D. C. Dec. 23, 1937). *But see* Green v. Gravatt, 19 F. Supp. 87 (W. D. Pa. 1937) (judicial interpretation of AFL constitution, but not a jurisdictional dispute).

Upon affiliation with the AFL in 1887, the Brewery Union was guaranteed the protection of its right to retain in membership all workmen engaged in the brewing industry, including those engaged in the transportation of brewery products. A demand by the Teamsters Union for jurisdiction over brewery drivers followed immediately upon that union's affiliation in 1899 and led to insertion in the AFL constitution of an article designed to prevent such disputes in the future. Concurrently the AFL reaffirmed the Brewery Union's control over drivers in the industry. The guarantee proved short-lived; the AFL convention in 1906 authorized the Executive Council to order transfer of beer drivers to the Teamsters. Upon its failure to surrender jurisdiction, the Brewery Union was suspended from the Federation. Restoration of the charter followed at the next annual convention, but, punctuated by years of armistice, the controversy continued, despite unceasing AFL efforts at settlement.[7] Finally the 1933 convention adopted a resolution deciding that brewery drivers properly belonged to the Teamsters. The AFL endeavored to carry out the resolution by instructing state federations of labor and central labor bodies to expel recalcitrant local brewery unions. President Green also advised employers of beer drivers henceforth to bargain collectively only with the Teamsters. Methods considerably more violent were undertaken by the latter union in attempting to give the resolution effect.[8]

Threatened with loss of membership and bargaining power, the Brewery Union sought refuge in a court of equity, asking that the AFL and the Teamsters be enjoined from attempting to effect a transfer of jurisdiction over beer drivers. The court proceeded upon the orthodox premise that the constitution and by-laws of the AFL, coupled with the Brewery Union's certificate of affiliation, formed a contract between the two.[9] Since its original charter expressly conferred upon the Brewery Union exclusive jurisdiction over beer drivers,[10] the court asserted that the AFL had never had power to shift the affiliation of these members without the Union's consent. The 1933 resolution was therefore declared null and void, and the injunction granted to prevent what "would amount to a judicial recognition of authority acquired by usurpation."[11]

7. In 1915 a "working agreement" was concluded between the two disputants, affirming jurisdiction of the Brewery Union over beer drivers. The court's opinion expressly makes this agreement irrelevant to the decision.

8. Brass knuckles, lead pipes and bombs were among the instrumentalities used by members of Teamsters locals. Victims were loyal beer drivers, their employers and taverns dealing with such employers. Obergfell v. William Green, 5 LAB. REL. REP. 163 (D. D. C., Oct. 6, 1939), Amended and Additional Findings of Fact 45-48.

9. Grand Internat. Brotherhood of Locomotive Engineers v. Couch, 236 Ala. 611, 184 So. 173 (1938); Robinson v. Dahm, 94 Misc. 729, 159 N. Y. Supp. 1053 (Sup. Ct. 1916); Lumber & Sawmill Workers Union No. 2623 v. Internat. Woodworkers of America, Local No. 49, 197 Wash. 491, 85 P. (2d) 1099 (1938).

10. As between AFL affiliates. Obviously no guarantee was made or is here enforced against a bid for the beer drivers by a CIO or independent union.

11. The court was untroubled by the Norris-LaGuardia Act, 47 STAT. 70 (1932), 29 U. S. C. § 101 *et seq.* (1934), since "the present suit sounds in contract." The Act's literal terms would seem applicable, but judicial evasion thereof may sometimes be justifiable, and is assuredly nothing new. See Legis. (1937) 50 HARV. L. REV. 1295, and authorities there collected.

It is suggested, however, that the court's disregard of possible implied terms of the contract has led to an over-simplified interpretation of its effect. The AFL constitution provides for organization of labor by crafts, not by industries.[12] When the Brewery Union's charter is read in the light of this provision, it would appear that the constitution has limited or modified the effect of a certificate of affiliation purporting to guarantee an industrial union's contemporaneous jurisdiction. While it is true that the AFL constitution contains no express provision for the adjudication of jurisdictional disputes, the constitutional amendment of 1900 clothes the AFL convention with power to ascertain whether a jurisdictional "trespass" upon affiliated unions is threatened.[13] It would appear therefore that this amendment impliedly empowered the annual conventions to decide jurisdictional disputes, since without this power the authorization to determine the existence of such disputes would be meaningless. Moreover, by its repeated appeals to Federation conventions and its willingness to rely upon favorable rulings thereof, the Brewery Union itself seems to have considered that the AFL had power to adjust these jurisdictional controversies.[14]

Even when there has been a breach of contract, equity has traditionally refused to interfere with an association's internal affairs when it has discovered no threat to property or civil rights.[15] The requirement has been seriously criticized,[16] yet, whatever the appropriate nomenclature, it remains true that some substantial interest should be directly endangered. The court was consequently careful to find an invasion of property interests, "probably the most valuable that unionized workers can have," and scrupulous to enumerate them: sick, death and strike benefits, and the benefit of collective bargaining. Though the materialistic jurisprudence of another day often found

12. Art. II, § 2 of the constitution provides for "the establishment of National and International Trade Unions, based upon a strict autonomy of each Trade, and the promotion and advancement of such bodies."

13. Art. IX, § 11: "No charter shall be granted . . . if the jurisdiction claimed is a trespass on the jurisdiction of existing affiliated unions . . .; no affiliated union shall . . . change its . . . name, if any trespass is made thereby on the jurisdiction of an affiliated organization, without having first obtained the consent . . . of a Convention." The convention must decide that a trespass is threatened before it can give or withhold its consent to a change in name.

14. Whatever the original terms of the contract, it could be held that rescission was effected by the Brewery Union's suspension in 1907. It has been held that contracts without time limit are terminable on reasonable notice by either of the parties. Restoration of the union's charter while the jurisdictional controversy continued would seem to indicate that any previous agreement purporting to settle that controversy must now be considered at an end.

15. State *ex rel.* Rhodes Mortician & Undertaking Co. v. New Orleans Funeral Directors' Ass'n, 161 La. 81, 108 So. 132 (1926); Franklin v. Penn-Reading Seashore Lines, 122 N. J. Eq. 205, 193 Atl. 712 (Ch. 1937); Carey v. International Brotherhood of Paper Makers, 123 Misc. 680, 206 N. Y. Supp. 73 (Sup. Ct. 1924).

16. *See* Chaffee, *The Internal Affairs of Associations not for Profit* (1930) 43 HARV. L. REV. 993, 1000. "The courts are so much occupied in declaring their unwillingness to protect anything except property, that they do not take the time to ascertain that an interest of substance is actually present in the particular case before them."

such rights too intangible for protection,[17] it is consistent with more mature concepts and with the trend of recent decisions to affirm such benefits as property.[18] Indeed, interests much more nebulous have been so categorized in order that a court might justify its invasion of an unincorporated association.[19]

Yet no interests which demand judicial protection appear to be inherently involved in the present case. It would seem that the court has failed to distinguish the substantial rights which are coincidentally present from the interests actually affirmed by its injunction. Those benefits which the court enumerates, its decision does not necessarily protect. Not the vested interests of workers, but the Brewery Union's right to jurisdiction, is the subject of the contract enforced by the court. A labor organization is thus given a property right in its members. Divorced from the fortuitous equities in the present situation, this would appear an extremely dangerous principle, increasing the possibility of the very autocracy and usurpation which the court so vehemently condemns.

In the present case it appears that the beer drivers actually would suffer an impairment of position by a transfer of allegiance.[20] It can therefore be argued that the contract was made for the benefit of the drivers and that their vested rights are invaded by its breach. These equities, and the logical argument that they support, obfuscate the suggested defects in the court's reasoning. These defects would become apparent, if the Teamsters were to secure more effective results from collective bargaining for their drivers than could the Brewery Union. Beer drivers would then want to change their allegiance; the Brewery Union would want to prevent such transfer. In that case[21] the court's ruling that the AFL had no power to alter this jurisdiction without the Brewery Union's consent would fail to protect property and would infringe upon the right of free association of which the court is so solicitous.

Another traditional doctrine forbids a court's intervention on behalf of one who has failed to exhaust his remedies within the organization.[22] It would seem that this requirement in the instant case was met. The Brewery Union appealed to three successive AFL conventions after the 1933 resolution before

17. Rigby v. Connol, 14 Ch. D. 482 (1880).

18. Fleming v. Moving Picture Machine Operators of Essex County, N. J., Local No. 244, 1 A. (2d) 850 (N. J. Ch. 1938).

19. Williams v. District Executive Board, U. M. W. of A., 1 Pa. D. & C. 31, (C. P. 1921) (protects mere possibility of election to office).

20. A referendum in 1934 showed 99.7% of the Brewery Union members against the proposed transfer. This would include almost all beer drivers in the union, indicating advantages to them of remaining where they were.

21. The hypothesis in the present situation is perhaps unrealistic. The superior bargaining position of an industrial union has been frequently emphasized. *See* BROOKS, *op. cit. supra* note 6, *passim*. The eventuality here suggested would be more likely to materialize, were both disputants craft unions.

22. Harris v. Missouri P. Ry., 1 F. Supp. 946 (E. D. Ill. 1931); Internat. Hod Carriers' Building & Common Laborers' Union of America, Local No. 426, v. Internat. Hod Carriers' Building & Common Laborers' Union of America, Local No. 502, 101 N. J. Eq. 474, 138 Atl. 532 (1927); Rubens v. Weber, 237 App. Div. 15, 260 N. Y. Supp. 701 (1st Dep't 1932).

seeking the injunction. It is settled that when further efforts within the association would be patently fruitless, even though logically possible, a court may intercede.[23] Moreover, a corollary to the general rule provides that when the association's action is wholly unconstitutional or arbitrary, further appeal within its framework is not necessary, and immediate resort to equity may be had.[24] This exception to the usual doctrine would apply to the present situation, if the court's finding that the AFL was never made arbiter of the brewery workers' destiny be accepted. Any doubt of the court's position as to the arbitrary nature of AFL conduct is dispelled by its forcefully stated proposition: "Whatever may be the factual situation at any time or place, wherever usurped authority comes in contact with jurisprudence of a democracy, it, then and there, instantly ceases to exist."

Even if it could be justified on doctrinal grounds, however, the injunction may be seriously criticized. Rules governing judicial interference with an association's internal affairs have largely evolved from litigation between an individual member and his organization. Such cases are not helpful analogies. No more helpful are the precedents of an injunction preventing an international union from ordering the abolition and merger of a 'district' which had accumulated large assets during many years of autonomous existence,[25] or an order that the American Legion reinstate a post expelled for violating the Legion's rule that no local could publicly disagree with the national convention.[26] Private property was directly threatened in the one case, and the important civil right of free speech in the other. Neither personal liberties[27] nor rights of property, but quasi-political interests are involved in the present case. A court should be as hesitant to evaluate and determine these interests as it is to intercede in other political controversies.[28] Objections similar to those against judicial interference with religious and educational organizations would seem likewise to be applicable.[29]

The relation between the Federation and its affiliates is not to be determined on principles of rigid contract law. Such a basis of adjudication is oblivious to the inevitable phenomenon of organic evolution and growth. Despite lacunae in the formal writings of association, the AFL has repeatedly been entrusted with the settlement of jurisdictional controversies.[30] The need

23. Local Lodge No. 104 of Internat. Brotherhood of Boilermakers, Iron Ship Builders, and Helpers of America v. International Brotherhood of Boilermakers, Iron Ship Builders, and Helpers of America, 158 Wash. 480, 291 Pac. 328 (1930).

24. Rueb v. Rehder, 24 N. M. 534, 174 Pac. 992 (1918).

25. Howard v. Weissmann, 31 F. (2d) 689 (C. C. A. 7th, 1929).

26. Gallaher v. American Legion, 154 Misc. 281, 277 N. Y. Supp. 81 (Sup. Ct. 1934).

27. "Civil rights" include not only Constitutional guarantees, but conventional standards of natural justice, analogous to "due process." *See* Chaffee, *supra* note 16, at 1014.

28. Georgia v. Stanton, 6 Wall. 50 (U. S. 1867); *see* WILLOUGHBY, PRINCIPLES OF THE CONSTITUTIONAL LAW OF THE UNITED STATES (2d ed. 1930) § 589.

29. *See* notes 2 and 3 *supra*. "The health of society will usually be promoted if the groups within it which serve the industrial, mental and spiritual needs of citizens are genuinely alive . . . Legal supervision must often be withheld for fear that it may do more harm than good." Chaffee, *supra* note 16, at 1027.

30. "Between 1917 and 1924 the Executive Council handled about 150 jurisdictional cases, of which about 50 were new disputes arising during these years." LORWIN, THE AMERICAN FEDERATION OF LABOR (Brookings Institute 1933) 340, n. 3.

of such a jurisdictional arbiter is a primary reason for the very existence of the AFL.[31] To hold a resolution of an AFL convention void and illegal is to provoke resentment and to invite failure.[32] The AFL is an autonomous voluntary confederation; its utility would appear to depend upon remaining autonomous, free from judicial intrusion.

No completely effective device[33] has been discovered for preventing or regulating disputes over jurisdiction — the most inefficient and purposeless of all labor controversies.[34] Sanctions are available, however, to minimize concomitant injuries to innocent parties. Workers threatened with loss of their jobs or of those benefits which the court enumerates in its opinion appear to be within the aegis of equitable cognizance.[35] Employers whose business is endangered as the result of violence or coercion by the Teamsters are free to seek judicial relief.[36] It is further suggested that sanctions of the public law are available to deter criminal behaviour of the Teamsters.[37] The present case, however, seems to offer no appropriate solution to the jurisdictional dispute problem. Rather, the court's natural anxiety to condemn apparent usurpation has led to a highly questionable decision. Judicial supersedure of a voluntary confederation's democratic action in order to protect a doubtful fifty-year-old 'contract' and to affirm a union's vested right to its members would seem to establish an unwise precedent.

31. "Unions are held together in the Federation by . . . the need for adjudicating jurisdictional disputes." *Id.* at 324.

32. The 1939 AFL convention excoriated the Brewery Union for not settling the dispute "within the family of labor." A Teamsters official there said: "I don't like the style of the brewery workers taking us into the courts. I don't like a scab or a squealer . . . I'm going to go along regardless of your court or your injunction and I'm going to get the brewery workers." N. Y. Times, Oct. 13, 1939, p. 17, cols. 2, 3.

33. Either within or without "the family of labor." The N. L. R. B. early decided not to intervene in such controversies. *See* In the Matter of Aluminum Company of America, 1 NLRB 530, April 10, 1936, holding that "self-organization of employees implies a policy of self-management." This policy has been given judicial approval. California Brewers Institute v. Internat'l Brotherhood of Teamsters, Chauffeurs, Stablemen and Helpers, 19 F. Supp. 824 (N. D. Cal. 1937). For difficulties encountered in AFL-CIO jurisdictional disputes, *see* (1939) 48 YALE L. J. 1053.

34. "The Federation deplores these disputes and is eager to eliminate them because they are costly, because jurisdictional strikes antagonize employees and consume much time, and because they create bitterness in the ranks of organized labor." Lorwin, *op. cit. supra* note 31, 342.

35. Truax v. Raich, 239 U. S. 33 (1915); Fleming v. Moving Picture Machine Operators of Essex County, N. J., Local No. 244, 1 A. (2d) 850 (N. J. Ch. 1938).

36. United Union Brewing Co. v. Beck, 93 P. (2d) 772 (Wash. Sup. Ct. 1939); International Union of United Brewing Workers v. California Brewers Institute, 25 F. Supp. 870 (S. D. Cal. 1938); California Brewers Institute v. International Brotherhood of Teamsters, Chauffeurs, Stablemen and Helpers, 1 A LAB. REL. REP. MAN. 661 (W. D. Wash. Oct. 22, 1937).

37. For a public sanction other than state criminal statutes, *see* N. Y. Times, Oct. 13, 1939, p. 1, cols 2-3 (indictment of Teamsters under Sherman Act).

FOREIGN DIVORCE AS AUTOMATIC TRANSFER OF LIFE INSURANCE POLICY*

WHEN a court is called upon to apply the law of another jurisdiction in a situation in which the law itself is not well settled, a mechanical application of general principles of the conflict of laws may lead to results unsatisfactory to both jurisdictions. The recent case of *New England Mutual Life Insurance Company v. Spence*[1] graphically illustrates this danger. In that case a federal district court sitting in New York granted comity to a local insurance rule of Texas so as to defeat the vested rights of a beneficiary under a Massachusetts life insurance policy. The policy was issued to Slade, the decedent, while he resided in New York, and was made payable to his wife without power reserved to change the beneficiary. Subsequently the couple became domiciled in Texas, and there were divorced; the decree made a property settlement, but failed to mention the life insurance policy. Both parties then remarried, and the wife returned to New York, where on the death of the insured she filed her claim under the policy. Since the decedent's administrator also claimed the proceeds of the policy, the insurance company, to determine the person to whom it was liable, interpleaded in the Federal District Court for the Western District of New York, naming as defendants both adverse claimants. The court awarded the proceeds of the policy to the wife,[2] but the circuit court on appeal reversed this judgment.[3] The rights of the wife, which were vested under the express terms of the policy, could be defeated only by a later valid transfer.[4] There was no voluntary assignment; but the court, granting comity to the unique Texas insurance doctrine[5] which requires that a beneficiary, in order to collect the proceeds of a policy, have a continuing insurable interest,[6] ruled that the divorce, in terminating the wife's insurable interest, automatically transferred to the insured's estate her rights under the policy.

To speak of granting "comity" to Texas internal rules of law has a convincing ring of courtesy and co-operation, and adherence to orthodox prin-

* New England Mut. Life Ins. Co. v. Spence, 104 F. (2d) 665 (C. C. A. 2d, 1939).

1. 104 F. (2d) 665 (C. C. A. 2d, 1939).

2. New England Mut. Life Ins. Co. v. Spence, 25 F. Supp. 633 (W. D. N. Y. 1938).

3. New England Mut. Life Ins. Co. v. Spence, 104 F. (2d) 665 (C. C. A. 2d, 1939).

4. Pennsylvania Co. for Insurances on Lives & Granting Annuities v. Comm'r of Internal Revenue, 79 F. (2d) 295 (C. C. A. 3d, 1935); Witherington v. Nickerson, 256 Mass. 351, 152 N. E. 707 (1926); Ruckenstein v. Metropolitan Life Ins. Co., 263 N. Y. 204, 188 N. E. 650 (1934); McNeil v. Chinn, 45 Tex. Civ. App. 551, 101 S. W. 465 (1907); 24 TEX. JUR. 762 (1935).

5. The Texas insurable interest rule is contrary to the corresponding rule of every other American jurisdiction. 52 A. L. R. 386, 397-399 (1928); VANCE, INSURANCE (2d ed. 1930) § 155, n. 14. Early Texas cases relied heavily on the dictum in Warnock v. Davis, 104 U. S. 775, 779 (1881), which seemed to indicate the necessity for a continuing insurable interest. This dictum was, however, specifically overruled in Grigsby v. Russell, 222 U. S. 149 (1911).

6. Equitable Life Ins. Co. v. Hazlewood, 75 Tex. 338, 12 S. W. 621 (1889); Cheeves v. Anders, 87 Tex. 287, 28 S. W. 274 (1894); Hatch v. Hatch, 35 Tex. Civ. App. 373, 80 S. W. 411 (1904).

ciples.[7] The difficulty in this case is that the basis for co-operation is lacking. There is no Texas law in point; all the cases relied on by the majority involved contracts made in Texas by Texas citizens.[8] It is therefore by no means as certain as the circuit court assumed that the Texas courts, even in a suit directly on the policy, would apply their rule and destroy vested rights under a foreign contract. It is even more doubtful whether the divorce action, which made no ruling as to the policy, can validly be said to effect an automatic transfer.[9] In this action there is added to the uncertainty as to the Texas law with regard to foreign contracts, the further question of the jurisdiction of the divorce court to adjudicate rights to the policy.

It might be said that by submitting to the divorce court the determination of their rights, the parties consented to any consequences which flow, under the law of the forum, from that determination.[10] This statement is misleading in its simplicity. The divorce decree certainly has the effect of destroying the wife's insurable interest; and at least in the case of a Texas contract, this may have the further effect of preventing recovery on the policy in the Texas courts. But it does not follow that the divorce decree itself results in an automatic transfer of the policy. It cannot well be argued that the parties consent in every action to all the law of the forum whether relevant or not to the particular suit. Their consent is limited to the adjudication of the rights they are litigating — here those of marital status. Unless, therefore, there is a relationship between the policy and the rights in dispute, it is very

7. It has been argued that the court's reasoning was circular, that it found an involuntary transfer had occurred in Texas by applying Texas internal law, and then felt obliged to follow Texas internal law because a transfer is governed by laws of the place of assignment. (1939) 39 COL. L. REV. 1224, 1225. The argument, however, is not convincing. The fault in the court's analysis seems to be not circularity of reasoning, but a misconception of the applicable Texas law.

8. Price v. Supreme Lodge, 68 Tex. 361, 4 S. W. 633 (1887); Schonfield v. Turner, 75 Tex. 324, 12 S. W. 626 (1889); Cheeves v. Anders, 87 Tex. 287, 28 S. W. 274 (1894); Hatch v. Hatch, 35 Tex. Civ. App. 373, 80 S. W. 411 (1904). The rather meager case law on this point in other jurisdictions also seems opposed to the decision of the majority in the instant case. *See* Pendleton v. Great Southern Life Ins. Co., 135 Okla. 40, 43, 273 Pac. 1007, 1009 (1929); *cf.* McGrew v. Mutual Life Ins. Co., 132 Cal. 85, 64 Pac. 103 (1901), *aff'd*, 188 U. S. 291 (1902). The *Pendleton* case held the law of place of contracting governs in determining whether the right of a beneficiary, the wife of the assured, is lost by divorce. *See* 2 BEALE, CONFLICT OF LAWS (1935) 1212. In Kentucky a statute provides that divorce shall prevent the recovery by the beneficiary on any insurance on the life of the former spouse. KY. STAT. ANN. (Carroll, 1936) §§ 654, 655. See Bradley v. Bradley, 178 Ky. 239, 198 S.W. 905 (1917); VANCE, INSURANCE (2d ed. 1930) § 155 n. 17. Other states have statutes which confer the power upon the insured to substitute another beneficiary in place of the one divorced. MINN. STAT. (Mason, 1927) § 3388; Mo. STAT. ANN. (1929) § 5739; N. Y. CIVIL PRACTICE ACT § 1160.

9. The majority's use of the concept of an automatic transfer has been criticized as "fictional" on the ground that the effect of divorce in the instant case has no real analogy to an actual assignment. (1939) 39 COL. L. REV. 1224, 1225. It is not, however, the fact that the concept is "fictional" but the fact that the "fiction" is inapt in the circumstances of the instant case that makes the court's use of the term unfortunate. New England Mut. Life Ins. Co. v. Spence, 104 F. (2d) 665, 668 (C. C. A. 2d, 1939).

10. Clark v. Willard, 292 U. S. 112 (1934); (1935) 48 HARV. L. REV. 835.

doubtful whether the court has jurisdiction to adjudicate the rights under the policy, and almost certain that the decree of the divorce court cannot itself operate to effect a transfer of these rights.

The reason many of the Texas cases give a divorce decree the effect of an automatic transfer is that in Texas insurance contracts may be community property.[11] A divorce decree, in shattering the marital bond, dissolves also this joint ownership of the policy by the ex-spouses.[12] Therefore, the divorce court has as a necessary auxiliary to its primary jurisdiction over the parties' status, the power to dispose of the policy.[13] Thus where the policy is community property, the divorce decree may validly be said to effect an automatic transfer.[14] Where, however, the policy is not community property,[15] the Texas court has itself held, in a case strongly emphasized by the majority in the instant case[16] and involving a Texas contract, that a divorce, though ending the wife's insurable interest, is not res judicata as to the rights in the policy, and does not operate to transfer it.[17]

11. Life insurance proceeds will become community or separate property according to the intention of the parties as shown by the insurance contract, and will not be dependent upon the character of the fund from which payment of premiums is made. Martin v. McAllister, 94 Tex. 567, 63 S. W. 624 (1901); Jones v. Jones, 146 S..W. 265 (Tex. Civ. App. 1912). *See* McKAY, COMMUNITY PROPERTY (2d ed. 1925) §§ 1-4.

12. Givens v. Givens, 195 S. W. 877 (Tex. Civ. App. 1917); SPEER, MARITAL RIGHTS IN TEXAS (1929) § 395. When community property is not divided by the divorce court, the former spouses hold such property as tenants in common. McKAY, COMMUNITY PROPERTY (2d ed. 1925) § 134.

13. A court's power to make a property settlement on divorce, like its power to grant a divorce, is statutory. McKAY, COMMUNITY PROPERTY (2d ed. 1925) § 1338. There is a Texas statute, which gives the divorce court wide discretion to make an equitable division of the spouses' property. TEX. STAT. (Vernon, 1925) art. 4638. This statute has been held to be mandatory. *Ex Parte* Scott, 123 S. W. (2d) 306 (Tex. Sup. Ct. 1939). There was, however, no need for the court in the principal case to afford this statute full faith and credit, since its primary function is to divide community property. Fitts v. Fitts, 14 Tex. 443 (1855); Hedtke v. Hedtke, 112 Tex. 404, 248 S. W. 21 (1923); 15 TEX. JUR. 582 (1935).

14. Northwestern Mut. Life Ins. Co. v. Whiteselle, 188 S. W. 22 (Tex. Civ. App. 1916), *aff'd*, 221 S. W. 575 (Tex. Com. App. 1920).

15. In the principal case property rights were vested in the wife and were, therefore, clearly the property, not of the community estate, but of one spouse only. The Texas Constitution holds that if property is acquired by gift or devise during marriage, it is separate property. TEX. CONST. Art. XVI, § 15. The purchase of a life insurance policy by the husband with the proceeds payable to the wife only is most convincing evidence of a gift and of the husband's intention to make proceeds wife's separate property. Evans v. Opperman, 76 Tex. 293, 13 S. W. 312 (1890); SPEER, MARITAL RIGHTS IN TEXAS (1929) § 421.

16. New England Mut. Life Ins. Co. v. Spence, 104 F. (2d) 665, 666 (C. C. A. 2d, 1939).

17. Hatch v. Hatch, 35 Tex. 373, 80 S. W. 411 (1903). See Whetstone v. Coffey, 48 Tex. 269 (1877), (although divorce court has power to make community property settlement, held, if this not done, divorced woman not precluded from afterwards bringing a suit to recover her interest in the property); Garnett v. Garnett, 114 Mass. 347 (1874), (in absence of statutory authority divorce court has no power to deal with separate property of spouses).

A fortiori, in a non-Texas policy, the divorce decree cannot be validly said to bar *per se* the rights of the wife-beneficiary. It is far from certain, moreover, that the Texas courts would not enforce the vested rights of the wife-beneficiary in a separate suit on the policy. Since the divorce decree does not effect a transfer in Texas, the law of the place where the contract was made remains, by general conflicts principles, controlling.[18] It seems, therefore, extremely likely that the Texas courts would grant comity to the New York insurance rule.[19]

It is possible, however, that the Texas courts, relying on a line of cases which attach special consequences to domicil,[20] might subordinate the concept of comity to the dominant public policy of the forum. There are, however, no Texas cases which indicate that the courts regard the public policy behind their insurable interest doctrine as dominant enough to justify its extension

18. Russo v. Slawsby, 276 Mass. 126, 176 N. E. 794 (1931); Quast v. Fidelity Mut. Life Ins. Co., 226 N. Y. 270, 123 N. E. 494 (1919); RESTATEMENT, CONFLICT OF LAWS (1934) § 332. When, however, a contract is transferred, it is governed by the law of the place of assignment. Wilde v. Wilde, 209 Mass. 205, 95 N. E. 295 (1911); Jackson v. Tallmadge, 246 N. Y. 133, 158 N. E. 48 (1927); RESTATEMENT, CONFLICT OF LAWS (1934) §§ 348, 350.

19. Ryan v. Missouri, K., T. R. R., 65 Tex. 13 (1885); Seiders v. Merchants' Life Ass'n, 93 Tex. 194, 54 S. W. 753 (1900); Fidelity Mut. Life Ins. Co. v. Harris, 94 Tex. 25, 57 S. W. 635 (1900). These cases have been relied on to show that Texas regards the law of the place of contracting as controlling. 2 BEALE, CONFLICTS OF LAWS (1935) 1166. Texas writers, however, state that the primary factor determining in Texas courts what law governs is the intention of the parties. Stumberg, *Conflict of Laws—Validity of Contracts—Texas Cases* (1932) 10 TEX. L. REV. 163; (1929) 7 TEX. L. REV. 627. In the principal case, since the intention of the parties is not stated clearly, it is presumed that they intended to be governed by the law of the place of contracting. 9 TEX. JUR. 359.

20. Union Trust Co. v. Grossman, 245 U. S. 412 (1918); Walker v. Goetz, 218 S. W. 569 (Tex. Civ. App. 1920); Taylor v. Leonard, 275 S. W. 134 (Tex. Civ. App. 1925). In all these cases special consequences were attached to domicil. For example, in the *Grossman* case a married woman, domiciled in Texas, by whose laws she was incapable of making a valid contract of suretyship, made such a contract in Illinois where a married woman has such capacity. In a suit on this contract in Texas, the court attached special significance to the public policy of the married woman's domicil and concluded that although she would have been unable to set up her coverture as a defense to an action brought in Illinois or any other jurisdiction, she should not be held liable on this contract. Accordingly, had the present case been brought in a Texas forum, the court, by extending the *Grossman* rule might have decided that the law of the controlling domicil determined whether the wife was disqualified by divorce from receiving the benefits of her husband's life insurance policy. Such an extension would, however, have been unwarranted. In the *Grossman* case, the wife's immunity during coverture not only was based on Texas authority squarely in point, but was also an adjunct of marital status, hence rightly connected with domicil. On the other hand, in the principal case, the disqualification arose not from the law of divorce or of property transfer, but from general insurance law—applicable to all insurance contracts alike. Therefore, since the wife's disqualification is not related to marital status, there is no basis for applying the rule of the *Grossman* case. *See* New England Mut. Life Ins. Co. v. Spence, 104 F. (2d) 665, 668 (C. C. A. 2d, 1929).

to non-Texas contracts.[21] And it seems unlikely that they would do so in the light of recent decisions which tend to modify this doctrine even as to Texas contracts.[22] Moreover, the possibility that the Texas courts might choose to extend the rule because of "dominant public policy" does not seem to justify the federal court in New York in barring the wife's recovery. Comity should be granted, not to inchoate and doubtful public policy, but only to definite rules of decision.[23] The court in the instant case was actually speculating as to what the Texas courts would do in a situation with which they had never been faced. This is a slender basis on which to defeat vested contractual rights and give extraterritorial effect to a peculiar and antiquated local insurance rule.[24] It is ironical that the beneficiary should lose her "vested" rights because a "liberal" forum felt called upon to apply the harsh rule of another jurisdiction when, had the suit been brought in the "unfavorable" jurisdiction, the beneficiary would probably have recovered.

LABOR RELATIONS BOARD DISAGREEMENT OVER APPROPRIATE EMPLOYEE BARGAINING UNIT*

RECENT opinions and dissents by Member Leiserson[1] of the National Labor Relations Board have focused attention on a fundamental conflict of rationale among the Board members as to the effect to be given to certain factors in the determination of appropriate employee units for collective bargaining. The National Labor Relations Act[2] grants the Board power to determine such units, and states that the choice is to be exercised among the "employer

21. *See* note 8 *supra.*

22. Shoemaker v. American Nat. Ins. Co., 48 S. W. (2d) 612 (Tex. Comm. App. 1932) (although divorced wife allowed to collect proceeds of the policy because it was considered a matured debt, an assignment by the husband to the wife in good faith was considered valid. The case establishes the proposition that a divorced wife can own an interest in an insurance policy on the life of her former husband if interest is limited in such a way as not to give her a motive for murdering him); Russell v. Russell, 79 S.W. (2d) 639 (Tex. Civ. App. 1934) (dictum that policy could be awarded to husband and wife could be compensated for her interest by awarding other property to her). *See* Huie, *Community Property Laws as Applied to Life Insurance* (1939) 17 TEX. L. REV. 121.

23. 3 BEALE, CONFLICTS OF LAWS (1935) 1647-1651.

24. The breadth of future application of the rule of the principal case is limited by the fact that similar situations will arise infrequently, since, before the doctrine of this case can be applied, the issues in litigation must have first been subjected to the jurisdiction of a foreign court by a primary transaction to which foreign law attaches definite secondary consequences. *But cf.* (1939) 39 COL. L. REV. 1224, 1226, n. 13.

* *In re* American Can Co., 13 N. L. R. B. No. 126, July 29, 1939.

1. William M. Leiserson was Chairman of the National Mediation Board, which administered the Railway Labor Act. He was appointed to the N. L. R. B. to take the place of D. W. Smith on April 25, 1939, (1939) 4 LAB. REL. REP. 301, and assumed his duties as a member of the Board on June 1, 1939. *Id.* at 513.

2. 49 STAT. 449 (1935), 29 U. S. C. § 151 *et seq.* (Supp. 1938).

unit, craft unit, plant unit, or subdivision thereof."[3] It requires the Board to choose that employee unit which will "insure to employees their full right to self-organization and to collective bargaining," and which will otherwise effectuate the statutory policies.[4]

The Statute fails to specify any objective criteria by which the various possible employee groupings in a given case might be evaluated in order to insure to employees their full right to collective bargaining. But the Board at an early stage found, by implication, indications of the appropriate employee unit in the history of labor relations within the particular industry or between the particular employer and his employees, in the skill required of various employees and the wages paid to them, in the organization of the employer's business, in the form of labor organization previously adopted by employees and in the eligibility of employees for membership in labor organizations.[5]

In 1937, after the development of these criteria, a situation arose in the *Globe Machine and Stamping Company* case,[6] where the factors pointing to one proposed employee grouping as appropriate were balanced by equally important considerations favoring another, and separation of certain craft groups from a larger body was equally as justifiable as their inclusion within the larger body itself. To meet this new situation, the Board established what is now known as the *Globe* doctrine of self-determination, ruling unanimously that craft groups were entitled in such cases to determine for themselves, by majority vote in separate elections, whether they wished to be included in the larger body or to be segregated for the purpose of collective bargaining.[7]

3. 49 STAT. 453 (1935), 29 U. S. C. § 159b (Supp. 1938). "The Board shall decide in each case whether, in order to insure to employees the full benefit of their right to self-organization and to collective bargaining, and otherwise to effectuate the policies of this act, the unit appropriate for the purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof."

"Such a determination is required in two types of cases: (1) Petitions for investigation and certification of representatives, pursuant to section 9 (c) of the act, and (2) complaints charging that an employer has refused to bargain collectively with the representatives of his employees, in violation of section 8, subdivision (5) of the act. In each instance, a finding as to the appropriate unit is indispensable to the ultimate decision." 1 NLRB Ann. Rep. (1936) 112. *See generally* Cohen, *The Appropriate Unit Under the National Labor Relations Act* (1939) 39 COL. L. REV. 1110.

4. *See* note 3 *supra.*

5. The various factors involved in determining the appropriate unit have been listed and commented upon by the N. L. R. B. 1 NLRB Ann. Rep. (1936) 112; 2 *id.* (1937) 122; 3 *id.* (1939) 156. For exhaustive treatment of the subject, *see* Cohen, *loc. cit. supra* note 3; Stix, *The Appropriate Bargaining Unit Under the Wagner Act* (1938) 23 WASH. U. L. Q. 156; Rice, *Determination of Employee Representatives* (1938) 5 LAW & CONTEMP. PROB. 188, 200 *et seq.;* Comment (1938) 32 ILL. L. REV. 593; Comment (1937) 12 WIS. L. REV. 367.

6. *In re* Globe Machine & Stamping Co., 3 N. L. R. B. 294 (1937). A similar situation was before the Board on the same day, with the same result. *In re* City Auto Stamping Co., 3 N. L. R. B. 306 (1937).

7. For discussion of this and similar decisions and their ramifications, *see* 3 NLRB Ann. Rep. (1939) 168; Cohen, *supra* note 3 at 1124; Rice, *loc. cit. supra* note 5; Comment (1939) 6 U. OF CHI. L. REV. 673; (1937) 47 YALE L. J. 122.

Shortly after promulgation of the *Globe* doctrine, its use in the *Allis-Chalmers Manufacturing Company* case[8] gave rise to the first dissent in the history of the Board. Chairman Madden and Member Donald Wakefield Smith made a finding that the usual considerations were balanced, and thereupon granted self-determination to craft groups; but Member Edwin S. Smith favored Board-determination of the larger group as the appropriate employee unit,[9] implying that these considerations should be found to balance only when the crafts involved have had a history of separate collective bargaining with the employer. In subsequent cases, E. S. Smith reiterated his dissent from the Madden and D. W. Smith interpretation of the *Globe* rule.[10] With the replacement of D. W. Smith by William M. Leiserson on June 1, 1939, E. S. Smith's dissenting view assumed new importance; for, should Leiserson accept it, it would replace the Madden interpretation of the *Globe* doctrine as the Board policy.

The issues of the *Allis-Chalmers Manufacturing Company* case were first presented for Leiserson's determination[11] on July 29 in the *American Can Company* case.[12] Three craft unions had petitioned the Board for segregation of their twenty employees from an existing industrial bargaining unit, comprising most of the 891 employees of the plant. The industrial unit objected, contending that it was the appropriate group. The usual determinants merely indicated that the Board would be justified in either segregating the crafts or including them in the larger body. The crafts were unable to show a history of collective bargaining with the employer; on the contrary, the industrial union proved that the craftsmen had been included in a labor contract which it had maintained with the company for two years. Madden favored self-determination by the crafts, in accordance with the majority reasoning in the *Allis-Chalmers Manufacturing Company* case. E. S. Smith

8. *In re* Allis-Chalmers Mfg. Co., 4 N. L. R. B. 159 (1937) (decided November 20, approximately four months after *In re* Globe Machine & Stamping Co., *supra* note 6).

9. Member E. S. Smith's dissent manifested a fundamental departure from Chairman Madden's and Member D. W. Smith's belief that crafts should bargain separately if they so desire; E. S. Smith started with the premise that the bargaining power of the great number of unskilled workers should not be reduced by the separation of a few key craft workers into separate bargaining units. *In re* Allis-Chalmers Mfg. Co., 4 N. L. R. B. 159, 175 (1937).

10. Smith testified on June 5, 1939, during hearings of the Senate Committee on Education and Labor concerning proposed amendments to the N. L. R. A., that he still believed in the reasoning of his dissent in the *Allis-Chalmers* case, and that over half of his 25 dissents to date were in opposition to application of the *Globe* doctrine in cases of the *Allis-Chalmers* type. *Hearings before Committee on Education and Labor on S. 1000, S. 1264, S. 1392, S. 1550, S. 1580 and S. 2123*, 76th Cong., 1st Sess. (1939) 1568; *id.* at 1569.

11. The issues of the *Globe* case arose twice between June 1st and July 29th, but in each instance a decision by Leiserson upon the issues of either the *Globe* case or the *Allis-Chalmers* case was avoided. *In re* Oppenheimer Casing Co., 13 N. L. R. B. No. 57, July 7, 1939; *In re* Locke Insulator Corp., 13 N. L. R. B. No. 70, July 17, 1939.

12. *In re* American Can Co., 13 N. L. R. B. No. 126, July 29, 1939, *summarized in* (1939) 4 LAB. REL. REP. 849.

reiterated the reasoning of his dissenting view in that case, and favored a Board decision that the crafts were to bargain as part of the larger group. Leiserson, though rejecting the reasoning of both, reached Smith's result — that segregation of crafts should be denied — by holding that the Board is not empowered by the N.L.R.A. to disturb or allow alteration of a bargaining unit established by the parties to a labor contract. The reasoning of the Leiserson opinion was completely foreign to both Madden's and Smith's conceptions of the Board's powers; Madden and Smith had always agreed that the Board was empowered to weigh the unit delineated in a labor contract as but one indicator of the proper employee group for collective bargaining,[13] and had disagreed only as to the proper Board action to be taken in some of the cases in which the various indicia, of which this was one, had balanced out.[14] Leiserson, however, ruled that where there has been a previous labor contract, the employee group there delineated is the *only* indicator which the Board may consider, and the Board must select that particular employee classification, regardless of other possible indicia.

Leiserson saw great advantages in a "rigid rule" which "binds the members of the Board";[15] he conceived that his doctrine, in cases where it is applicable, would keep the Board from "taking sides in jurisdictional controversies among labor organizations which differ as to the most effective form of organization for collective bargaining purposes,"[16] and reduce the Board's duties to those of a mere fact-finding body, thus making it completely neutral.

But actually, a Board bound by the Leiserson rule would *not* be neutral; it would strongly favor industrial unionism. In some cases this would act as a permanent bar to the representation of craftsmen by craft unions, while it would never in similar cases so bar representation by industrial unions. For example, if the first labor contract were one obtained for a plant-wide employee group by an industrial union, Leiserson's rule would deny to crafts the privilege of a separate representation election; the effect of such denial would be to deprive the crafts of representation by craft unions unless they could obtain a consent to the segregation from a majority of the workers in the industrial unit,[17] which would be, of course, extremely unlikely. Yet if the first labor contracts were obtained for crafts by craft unions, nothing

13. The previously established Board view is stated in its annual reports, "The form which self-organization has taken among the employees involved in a proceeding, or among workers similarly situated, is one of the most significant factors in determining the appropriate unit. Self-organization which has resulted in successful collective bargaining in the past can be relied on as a guide for future collective bargaining." 2 NLRB Ann. Rep. (1937) 125; 3 *id.* (1939) 160.

14. *See* note 10 *supra.*

15. *In re* Milton Bradley Co., 15 N. L. R. B. No. 105, Oct. 6, 1939. (Leiserson's prevailing opinion in a case comparable to In re *American Can Company* in both facts and opinion).

16. *Ibid.*

17. If the industrial unit will consent to the proposed segregation of crafts, the Board will usually determine such crafts separate appropriate units for collective bargaining purposes. See Rice, *supra* note 5, at 201, and cases there cited.

would prevent the crafts from voting, in their separate elections, to be represented by an industrial union.[18]

And even if the Leiserson doctrine were neutral, the benefits obtainable from this rigid rule of law would not offset the harmful effects of its restriction of Board discretion. The Board would be forced to approve the haphazard employee groupings established at the inception of collective bargaining within a company, without being able to consider either the natural, most efficient classification of employees[19] or the classification generally used elsewhere in the industry.[20] And the Board would be forced to discontinue its present desirable policy of approving unnatural employee groupings in order to hasten collective bargaining,[21] if it could no longer alter the groups so established.[22]

In cases where it is applicable, Leiserson's rule has made Smith's dissent in the *Allis-Chalmers* case the Board policy. When, as in the *American Can Company* case, there has been a previous industrial-type labor contract and the *Globe* rule is applicable, Leiserson favors an industrial employee group,

18. Crafts will be allowed to vote for representation by an industrial union even though, at the time, the crafts have collective bargaining contracts with the employer. Rice, *supra* note 5, at 194.

19. *See In re* Clyde Mallory Lines, 15 N. L. R. B. No. 111, Oct. 10, 1939 (employees engaged generally in maintenance and repair work had been arbitrarily split by a collective bargaining contract into two groups as a result of fortuitous organizational development of rival labor unions; Leiserson refused to agree to the merger of the two groups into one bargaining unit).

20. In *In re* West Coast Wood Preserving Co., 15 N. L. R. B. No. 1, Sept. 1, 1939, Leiserson's prevailing opinion denied self-determination to crafts because of their previous inclusion in an industrial labor contract, although these crafts bargain separately elsewhere in the industry; see *In re* Globe Newspaper Co., 15 N. L. R. B. No. 106, Oct. 7, 1939, in which Leiserson dissented from the majority's inclusion of craft employees in a larger group where the craft employees had been excluded from a previous labor contract, although the industry uniformly included the craft in the larger group for bargaining purposes. However, in *In re* Philadelphia Inquirer Co., 14 N. L. R. B. No. 38, Aug. 18, 1939, Leiserson concurred to the inclusion of crafts in a case similar to In re *Globe Newspaper Company. But cf.* Brotherhood v. Nashville, C. & St. L. Ry., 94 F. (2d) 97 (C. C. A. 6th, 1937) (under Railway Labor Act, National Mediation Board's inclusion of crafts in a larger unit in accord with practice elsewhere in industry held arbitrary upon showing of previous separate bargaining by the crafts).

21. *In re* Globe Newspaper Co., 15 N. L. R. B. No. 106, Oct. 7, 1939 (a craft, properly a separate appropriate unit, temporarily included by the Board in a larger unit, pending organization of the craft); *In re* Great Lakes Steel Corp., 14 N. L. R. B. No. 14, Aug. 4, 1939 (organized employees operating railroad in one plant temporarily excluded from a proper unit of employees operating railroads in all plants, pending organization of employees operating railroads in other plants); *In re* Burroughs Adding Machine Co., 14 N. L. R. B. No. 62, Aug. 19, 1939 (organized employees in one office of company excluded from proper unit of employees in all offices, pending organization of employees in other offices); see *In re* Iowa Southern Utilities Co., 15 N. L. R. B. No. 62, Sept. 22, 1939.

22. Leiserson's rule would not allow the groups so established to be altered, once such groups had obtained collective bargaining contracts. See *In re* Bendix Products Corp., 15 N. L. R. B. No. 107, Oct. 7, 1939 (alteration denied, Leiserson concurring).

and Madden favors self-determination. If Smith finds no history of separate collective bargaining by the crafts, as in the *Allis-Chalmers* case, he can concur with Leiserson; while if he finds that such a history exists, as in the *Globe Machine and Stamping Company* case, he can concur with Madden. When, on the other hand, there have been previous separate craft bargaining contracts and the *Globe* rule is again applicable, Leiserson favors separation of the crafts, Madden favors self-determination, and Smith finds in the contracts enough history of separate bargaining by the crafts to justify his concurring with Madden in granting self-determination. Since the Leiserson rule, when applicable, makes Smith's dissent in the *Allis-Chalmers* case the rule of the Board, it seems improbable that Smith would be willing to reconcile his views with those of Madden,[23] or take other action to render the Leiserson opinion nugatory.

Madden will probably continue to dissent vigorously but ineffectively to the Smith and Leiserson views, when they combine to deny self-determination in cases where it previously would have been granted,[24] but it is unlikely that he will attempt to restore the former Board rule by any means other than by making further efforts to persuade the other Board members to restore it.[25]

But the present Board policy may be changed by Leiserson's own alteration of his rule. He may decide that the success which the National Mediation Board experienced with his doctrine[26] in its administration of the Railway Labor Act[27] was due, in part, to the peculiar position of dominance which craft unions enjoy in the railroad field. Railroad labor had firmly established crafts as the important bargaining units long before the Leiserson rule was first applied, so that the possibility was remote that the rule, which operates to prevent smaller units from obtaining separate representation, would ever deprive a craft of the privilege of bargaining separately. Yet the doctrine did provide a solution to one of the chief problems of the National Mediation Board by curbing attempts of discontented minorities in well-defined crafts to obtain separate representation.[28]

23. A reconciliation of the Smith and Madden views is unquestionably desirable. *See* Comment, *N. L. R. B. Divided on Appropriate Bargaining Unit* (1939) 8 INT. JURID. ASS'N BULL. 31. But it is unlikely that Smith will alter his present view to achieve such a result.

24. For Madden's dissents in such cases, see *In re* West Coast Wood Preserving Co., 15 N. L. R. B. No. 1, Sept. 1, 1939; *In re* Milton Bradley Co., 15 N. L. R. B. No. 105, Oct. 6, 1939; *In re* Bendix Products Corp., 15 N. L. R. B. No. 107, Oct. 7, 1939; *In re* Roberts & Manders Stove Co., 16 N. L. R. B. No. 78, Oct. 31, 1939.

25. Madden could attempt to restore the former Board rule by several other means, if he so chose; he could request a legislative guide for the Board, or he could concur with Leiserson in a test case, seeking court determination that the Leiserson doctrine is arbitrary.

26. Leiserson so states in his opinion in *In re* Milton Bradley Co., 15 N. L. R. B. No. 105, Oct. 6, 1939.

27. 44 STAT. 577 (1926), amended 48 STAT. 926, 1185 (1934), 45 U. S. C. § 151 *et seq.* (1934).

28. "On the basis . . . of experience . . ., the Board is impressed that the tendency to divide and further subdivide established and recognized crafts and classes of employees has already gone too far . . ." 1 NAT. MED. BOARD ANN. REP. (1935) 21.

Recent decisions by Leiserson may indicate that he has already attempted to offset the advantage which his rule gives to industrial unionism;[29] he has held that the Board is not bound to accept a plant-wide bargaining unit delineated in a previous labor contract, if the crafts seeking segregation can show, by any construction of the facts[30] or of the contracts,[31] that they had not acquiesced to their inclusion in the larger unit. Other recent Leiserson decisions have left the way open for him further to limit his rule in the future. In situations of the *Allis-Chalmers* type where there are no previous labor contracts involved, Leiserson, in disagreeing with Madden and Smith, has favored Board-determination of the craft groups as proper, separate bargaining groups;[32] if his dissent were adopted by the Board, he might feel justified in ruling, at same later time, that crafts once separated by the Board should always be granted separate representation elections in spite of intervening industrial contracts. And his concurrance in the *L. B. Lockwood Company* case[33] opens the door for another restriction of his rule; he may now hold that if a craft had once obtained a separate collective bargaining contract, or had merely been excluded from an industrial-type labor contract,[34] the Board may grant to the craft the privilege of self-determination, even though the craft had meanwhile been included in a plant-wide labor contract.

29. As of Nov. 9, 1939.

30. *See In re* Chicago Malleable Castings Co., 16 N. L. R. B. No. 9, Oct. 16, 1939 (Leiserson's concurring opinion); *In re* Toledo Steel Tube Co., 15 N. L. R. B. No. 95, Oct. 3, 1939 (Leiserson's concurring opinion); *In re* Globe Newspaper Co., 15 N. L. R. B. No. 106, at 10, Oct. 7, 1939 (Leiserson's dissenting opinion); *In re* Sloss Sheffield Steel and Iron Co., 14 N. L. R. B. No. 13, Aug. 4, 1939 (by implication).

31. *See In re* B. F. Goodrich Co., 16 N. L. R. B. No. 19, Oct. 19, 1939 (Leiserson's concurring opinion).

32. For recent Leiserson opinions to this effect, *see In re* Toledo Steel Tube Co., 15 N. L. R. B. No. 95, Oct. 3, 1939; *In re* Willys Overland Motors, Inc., 15 N. L. R. B. No. 98, at 8, Oct. 4, 1939; *In re* Stokely Bros. & Co., 15 N. L. R. B. No. 99, Oct. 4, 1939; *In re* Walgreen Co., 15 N. L. R. B. No. 109, Oct. 9, 1939; *In re* Armour & Co., 16 N. L. R. B. No. 38, Oct. 24, 1939.

33. *In re* L. B. Lockwood Co., 16 N. L. R. B. No. 11, Oct. 17, 1939.

34. *See In re* L. B. Lockwood Co., 16 N. L. R. B. No. 11, Oct. 17, 1939 (Leiserson concurring to a grant of self-determination to crafts once excluded from industrial labor contract, later included); *In re* Globe Newspaper Co., 15 N. L. R. B. No. 106, at 10, Oct. 7, 1939 (Leiserson dissenting to a denial of self-determination to crafts once excluded from an industrial labor contract).

If Leiserson were willing to grant self-determination to crafts which had been merely excluded from a previous labor contract, it should follow that he would grant self-determination to crafts which had had separate bargaining contracts. *But see In re* Philadelphia Inquirer Co., 14 N. L. R. B. No. 58, Aug. 18, 1939, an earlier case in which Leiserson and Madden denied self-determination to crafts which had previously obtained separate bargaining contracts.

INTERNATIONAL ARBITRATION OF THE BLACK TOM AND KINGSLAND CASES*

THE Treaty of Berlin,[1] ending the war between the United States and Germany, reserved for future settlement all claims of American nationals against the German Government. To insure the payment of all valid claims, the American Government was to retain possession of all sequestered property until Germany made suitable provision for the satisfaction of American claims.[2] Pursuant to these provisions, the Mixed Claims Commission was established in 1922 to adjudicate the claims by arbitration.[3] The Commission was to consist of an American and a German commissioner and an umpire who would be acceptable to both governments.[4] The umpire, however, was not to be a fully empowered adjudicator; he was to decide only those points upon which the national commissioners should disagree.

Prominent among the claims filed with the Mixed Claims Commission were the *Sabotage* cases,[5] popularly known as the *Black Tom* and *Kingsland* cases. The memorials[6] of the United States alleged that in 1916 and 1917 German agents, intending to destroy munitions bound for the Allies, had fired the Black Tom Terminal in New York Harbor and the Kingsland Ammunition plant at Kingsland, New Jersey. In 1930 the Commission unanimously decided that the claimants had not advanced sufficient proof and dismissed the cases.[7] The following year a petition for rehearing, alleging mistakes of law and a misunderstanding of the facts, was dismissed with the statement that, although the rules of procedure made no provision for rehearings, the

* United States on behalf of Lehigh Valley R. R., Agency of Canadian Car & Foundry Co., Ltd., and Various Underwriters v. Germany, before Mixed Claims Comm., United States and Germany, Docket Nos. 8103, 8117 *et al.*, sitting under Agreement of Aug. 10, 1922, 42 STAT. 2200, U. S. TREATY SER. 665 (1922).

1. Proclaimed Nov. 14, 1921, 42 STAT. 1939, U. S. TREATY SER. 658 (1921).

2. Under the Trading with the Enemy Act, 40 STAT. 411 (1917), 50 U. S. C. A. § 7 (App. 1928) over $500,000,000 worth of enemy property was seized by the Alien Property Custodian.

3. The Agreement of 1922, 42 STAT. 2200, U. S. TREATY SER. 665 (1922) was approved by the legislatures in Germany and by executive agreement in the United States.

4. The original personnel of the Commission consisted of Justice William R. Day of the Supreme Court as umpire, Judge Edwin B. Parker as American Commissioner, and Wilhelm Kiesselbach as German Commissioner. Judge Parker became umpire and Chandler Anderson, American Commissioner, in 1923. Justice Roberts of the Supreme Court was appointed umpire in March, 1932, succeeding Roland W. Boyden who had followed Judge Parker. It is to be noted that since the establishment of the Commission, the umpire has always been an American.

5. United States on behalf of Lehigh Valley R. R., Agency of Canadian Car & Foundry Co., Ltd., and Various Underwriters v. Germany, before Mixed Claims Comm., United States and Germany, Docket Nos. 8103, 8117 *et al.*, sitting under Agreement of Aug. 10, 1922, 42 STAT. 2200, U. S. TREATY SER. 665 (1922).

6. The claims of private individuals espoused by their governments are generally submitted to arbitration commissions in the form of memorials involving less formality than claims by a government on its own behalf. *See* RALSTON, THE LAW AND PROCEDURE OF INTERNATIONAL TRIBUNALS (rev. ed. 1926) § 358.

7. Opinion printed in (1931) 25 AM. J. INT. LAW 147.

contentions had been carefully considered and found without merit.[8] Another attempt to secure a rehearing, this time on the allegation of newly discovered evidence, failed in 1932 when the umpire, Mr. Justice Roberts of the Supreme Court, decided that the new evidence did not justify a departure from the original decision.[9] The decision thus successfully evaded a determination of the Commission's power to reopen their adjudications.

Undaunted by these repeated rebuffs, the claimants then tried a new technique. They moved for a reopening on the ground that the Commission had been misled in its original decision by fraud, collusion and suppression of evidence. Faced with these allegations, Mr. Justice Roberts declared in 1933 that since no tribunal worthy of respect could allow its decision to stand if the charges of fraud were well founded, the cases would now be reopened.[10] In 1935 the American Agent filed a motion requesting that if the allegations of fraud were substantiated, the Commission in the same decision should determine the cases on their merits. In deference to objections by the German Commissioner, however, the Commission denied the motion and asserted that their first decision would be limited to the question of fraud.[11]

In January 1939, the evidence was at last fully presented and the issue of fraud was submitted to the Commission for determination. While the deliberations were still in progress, the German Commissioner resigned, alleging bias on the part of Mr. Justice Roberts. Notwithstanding the absence of any German representative, the American Commissioner submitted a purported certificate of disagreement to the umpire. Mr. Justice Roberts' opinion, rendered on June 15, not only upheld the charges of fraud, but also declared that by establishing the responsibility of Germany for both fires, the claimants had prevailed on the merits.[12]

8. Opinion of March 30, 1931, printed in (1933) 27 AM. J. INT. LAW 339.

9. Opinion printed in (1933) 27 AM. J. INT. LAW 345. In this opinion Justice Roberts found that two sets of documents, relied on heavily by the claimants, were not authentic. One was the "Wozniak letters" indicating that the writer, one Wozniak, at whose work-bench the Kingsland fire had started, consorted with German agents in Mexico in 1917. The other was the "Herrmann message" written in lemon juice on the pages of a "pulp" magazine. The message allegedly sent by one Herrmann to one Hilken, both avowed German agents, mentioned the suspects of the *Kingsland* and *Black Tom* cases and stated that both fires had been reported to his superior in Mexico. The magazine was allegedly discovered in Hilken's attic in 1930. Germany produced evidence that it was purchased after 1930 from a second-hand book store in Brooklyn, Justice Roberts stated that, apart from the conflict of expert testimony, he was convinced in his own mind as to spuriousness of the message. The message is especially noteworthy in that it covers and clears up all the points which in the decision of 1930 had been found inadequately proven.

10. Opinion of December 15, 1933 (mimeographed). It was also held in this opinion that newly discovered evidence did not provide a basis for reopening.

11. Opinion of July 29, 1935 (mimeographed). To restore the status of the cases to that established by the original decision of 1930, the 1932 decision was set aside in 1936; it was again stated that the merits would not be adjudicated at the first submission. Opinion of June 3, 1936 (mimeographed).

12. Opinion of June 15, 1939 (mimeographed). The opinion contains a prior history of the case. The opinion was written by the American Commissioner, Christopher Garnett, and adopted by the umpire.

The propriety of this reopening of the original decision of 1930 is subject to serious question in that the Agreement of 1922, which defined the duties and powers of the Commission, provided that "all decisions . . . shall be accepted as final and binding upon the two governments."[13] Mr. Justice Roberts, however, construed this provision as a covenant binding the two governments with respect to any decision to be made, but not purporting to define what is to be considered a "decision"; all questions of finality, he said, were left to the Commission. But even under this interpretation, it is difficult to accept the three attempts by the American agent to set aside the original decision as an observance of the covenant. If the provision, under any interpretation, permits constant efforts for nine years to reverse the first disposition of the cases, the restriction might as well have been absent entirely.

The decision of 1933 reopening the cases raises a further question as to the jurisdiction of the umpire. This determination was rendered by an umpire who, by the terms of the Agreement of 1922, was to decide issues only in the event of disagreement between the national commissioners.[14] By the Commission's Rules of Procedure, notification of disagreement was to be communicated to the umpire by a written certificate signed by each arbitrator.[15] In other arbitration proceedings, umpires have refused to entertain petitions for rehearings which were addressed to them in the first instance,[16] or did not come before them in the prescribed manner.[17] The present communication of disagreement consisted merely of an informal letter and opinion of the German Commissioner expressing views opposed to the privilege to reopen.[18] Despite the terms of the Rules of Procedure and a previous holding by the Umpire of the Spanish Claims Commission of 1871, that he would not hear disputes where one arbitrator refused to certify the disagreement,[19] Mr. Justice Roberts decided to hear the issue. In justification he stated that the Agreement said nothing of a formal means of expressing disagreement, and that the Rules could not, by providing for formalities, "contravene the explicit terms of the instrument." However worthy may have been his apparent desire to prevent a permanent stalemate, the argument is unconvincing that the Rules contravened the express terms of the Agreement when in fact that instrument said nothing on the subject.

13. 42 STAT. 2200, U. S. TREATY SER. 665 (1922).

14. *Ibid.* In the field of private arbitration the umpire fulfills the same function. S. J. Stewart v. Mansura Cotton Oil Mill Co., 148 So. 496 (La. App. 1933).

15. RULES OF PROCEDURE, Mixed Claims Commission (ed. 1929) Art. VIII.

16. In the *Weil* and *La Abra* cases, (1876) 2 MOORE, ARBITRATIONS 1329, two awards rendered by the Mexican Claims Commission of 1868 in favor of American claimants were alleged to have been procured by fraud. The umpire refused rehearing. Mexico appealed to the State Department, but did not obtain complete restitution until 1902. *See* SANDIFER, EVIDENCE BEFORE INTERNATIONAL TRIBUNALS (1939) § 103; the cases provide a precedent against the umpire's granting a reopening, but are hardly eloquent testimonials to the expediency of referring the problem to the State Department.

17. (1881) 3 MOORE, ARBITRATIONS 2192.

18. The facts relating to the communication of disagreement appear in the mimeographed opinion of Dec. 15, 1933.

19. 3 MOORE, ARBITRATIONS 2192. This decision did not arise out of any specific claim but on a motion by the American advocate for an order of the commission granting his right to appear before the umpire as a matter of general procedure.

Although the reopening may have been in conflict with the Agreement and the Rules of Procedure, there is no denying the force of Mr. Justice Roberts' argument that a tribunal should not defend the finality of a decision in the face of allegations that it was induced by fraud.[20] Fraud is generally considered a ground sufficient to nullify an arbitral award,[21] and of all the reasons for permitting a reopening, fraud is the most persuasive. The allegations, however, were only of the most general nature: fraud, collusion, and suppression of evidence, all mere legal conclusions. They did not purport to state the facts which constituted the fraud;[22] yet these allegations sufficed to keep the cases open for six more years while evidence to sustain them was being collected. The entering of an order that the basis for the charge be stated would have gone far towards discovering whether the allegations were bona fide or a stall for more time.

A further issue is presented by the continuance of the cases by the American Commissioner and the umpire after the resignation of the German Commissioner. The opinion of 1939 cites *Colombia v. Cauca Company*[23] as authority for the procedure adopted, but the circumstances in that case had little in common with the present situation. In the *Cauca* case a commission of three had been established to arbitrate issues arising out of a railroad concession. After the trial, when only the formal signing of the award remained, the Colombian Commissioner resigned. Since the Commission's legal existence expired in seven more days, there was no time for the formalities of appointing a successor, and the award was signed by the two remaining commissioners. The procedure was ratified by the Supreme Court, which held that a party could not so defeat the purposes of the arbitration by withdrawing its representative at the last minute. The element which necessitated the amended procedure in the *Cauca* case was not present in the *Sabotage* cases, however, since there was no set date for the termination of the Mixed Claims Commission. The procedure set forth in the Agreement for the appointment of a successor should therefore have been followed, leaving the problems of treaty observance within the province of the State Department.

20. In private law, fraud sufficient to set aside a judgment of a court must be extrinsic and collateral to matters directly involved in the suit. Perjury is considered intrinsic and is not sufficient. Adams v. Martin, 3 Cal. (2d) 246, 44 P. (2d) 572 (1935); State *ex rel.* Adam *et al.* v. Martin, 198 Ind. 516, 154 N. E. 284 (1926); Vacuum Oil Co. v. Brett, 150 Okla. 153, 300 Pac. 632 (1931). In the field of private arbitration there is a conflict of authority as to whether an award can be attacked for intrinsic fraud. The cases are collected in Jacobowitz v. Metselaar, 268 N. Y. 130, 197 N. E. 169, (1935), 99 A. L. R. 1198, 1202 (adopting the same rule for awards as for judgments and refusing to set aside award on grounds of perjury).

21. CARLSTON, THE NULLITY OF INTERNATIONAL ARBITRAL AWARDS (Unpublished thesis in Yale Law School Library, 1933) 121.

22. In private arbitration, to justify consideration of the impeachment of an award on the grounds of fraud, the facts alleged to constitute fraud must be stated. General allegations will not suffice. McMullen v. Lewis, 32 F. (2d) 481 (C. C. A. 4th, 1929), *cert. denied*, 280 U. S. 566 (1929); Thompson v. Edwards, 220 Ky. 239, 294 S. W. 1095 (1927); Eubank v. Bostick, 194 S. W. 214 (Ct. Civ. App. Tex. 1917).

23. 190 U. S. 524 (1903).

It must be conceded that obstructionist tactics are not to be encouraged, but the means adopted to defeat them can not depart from the instrument from which a commission derives its powers. Unlike the commission in the *Cauca* case, which was composed of three members empowered to render a majority award, the Mixed Claims Commission has but two members, with an umpire to be called in only if the deliberations result in disagreement. Since the resignation here took place while the deliberations were still in progress, a certification, however informal, that the deliberations culminated in disagreement, was impossible. To avoid these difficulties, the Rules of Procedure treated so cavalierly in the opinion in 1933 were now invoked. For reasons of expediency in the event of a disagreement, the Rules had been changed in 1929 to provide that the umpire should sit with the commissioners and participate in the hearings.[24] It was decided, therefore, that by these amended Rules the Commission was rendered a commission of three, empowered to render a majority award. The Rules of Procedure were thereby permitted to change the structure of the Commission as established by the Agreement of 1922, although it had previously been decided in 1933 that the Rules could not contravene the agreement. Although rendered unnecessary if the umpire was now a commissioner, a certificate of disagreement was nevertheless filed, but oddly enough the Rules did not maintain their newly-found importance; for again, as in 1933, the certificate was signed only by the American Commissioner rather than by both as required by the Rules.[25]

It will be remembered that, despite statements in two prior opinions that the Commission would at present consider only the issue of fraud, the opinion of 1939 decided not only this issue, but also that the claimants had prevailed on the merits. Justification for this change was found by stating that the 1936 opinion held that fraud would be the only issue "unless Germany shall agree to a different course"; it was now asserted such an agreement had in fact been made. It had been Germany's position that even if the fraud were established, the original decision dismissing the claims should not be set aside unless the claimants' proof was adequate to change the result. To bolster such proof as already existed, more evidence on the merits was therefore filed by the claimants. Germany, as would be expected, also filed evidence seeking to keep the American proof in its doubtful state. This was fatal, as it was held that the filing of evidence by Germany other than on the issue of fraud was an agreement to a different course, and the question of fraud would no longer be isolated. Germany's counterfiling to the voluminous evidence of the claimants thus became an "agreement" by her to abandon her insistence that the merits of the cases not be discussed at the first submission.

It is not feasible, of course, to comment on the merits of the cases, but in finding that the Commission had been misled by fraud in 1930, this body admitted to a greater naiveté than the facts justified. Even then the Com-

24. This procedure enables the umpire, though he may never be called on to render the deciding opinion, to familiarize himself with a case and saves recommunication of a case to him in the event of disagreement by the arbitrators.

25. RULES OF PROCEDURE, Mixed Claims Commission (ed. 1929) Art. VIII.

mission had been perfectly clear on two points: first, that during American neutrality, a general sabotage campaign existed in this country,[26] although the proof was inadequate to establish the specific cases, and second, that some of the witnesses on both sides were cranks and perjurers.[27] Although the Commission in 1930 had not been misled on these points, Germany's denial of this sabotage campaign was now a ground of fraud which had deceived the Commission in its original decision. In addition, although the Commission in 1930 had recognized much of the German testimony as suspect,[28] the Commission was now said to have been deceived in its decision by perjury. Finally on the merits, new evidence, held not to constitute grounds for reopening in 1933, convinced the Commission that this time the American case was made out.

Irrespective of any question on the facts, the procedure adopted in reaching the conclusion was ill-advised and unfortunate for the general cause of international arbitration. Germany has filed a protest with the State Department, and the award is now being collaterally attacked by other claimants, on the ground that it was rendered without jurisdiction.[29] These claimants, who were only partially paid on their own awards, are seeking an injunction against disbursing funds sequestered in the Treasury to the sabotage claimants.[30] Whatever the results of these attacks may be, the Mixed Claims Commission has ended its labors in an atmosphere of strife and ill-feeling which goes far towards nullifying the excellent and harmonious record established in other cases.[31]

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26. In the opinion of 1930 printed in (1931) 25 AM. J. INT. LAW 147, the Commission, referring to the sabotage policy says at page 149: "We see no evidence in these cases, however, that such authority as the political section of the General Staff gave was ever modified." And at 158: "We can be sure, however, that any German agent seeking for a chance to destroy munitions would have looked upon Black Tom with the keenest interest."

27. *Id.* at 151: "Hilken and Herrmann are both liars, not presumptive but proven." and at 154: "Wozniak has shown in connection with matters having nothing to do with the fire that he would not let a little thing like truth stand in his way."

28. *See* notes 26 and 27 *supra.*

29. Zimmerman and Forshay Assets Realization Corp. v. Cordell Hull, Sec'y of State, and Henry Morgenthau, Sec'y of Treasury, N. Y. Times, Nov. 1, 1939, p. 2, col. 1.

30. The sabotage claims with interest come to around $50,000,000. About $24,000,000 remains in the German Special Deposit Account. The great part of the original property in the hands of the Alien Property Custodian has been returned to nationals of the former enemies under the Settlement of War Claims Act, 45 STAT. 254 (1928), 50 U. S. C. A. § 9 (App. 1928). Other claimants have also received payments on their awards.

31. *See* KIESSELBACH, PROBLEMS OF THE GERMAN AMERICAN CLAIMS COMMISSION (1930); Fehr, *American and German War Claims Settled* (1933) 18 A. B. A. J. 896.

TAXATION OF CAPITAL GAINS ON TAX-EXEMPT FEDERAL SECURITIES*

MANIFOLD considerations, social and economic, have led courts in recent years to whittle away at constitutional principles[1] and statutory clauses[2] which once sufficed to exempt federal security issues from taxation. In curtailing the area of exemption, judges have displayed considerable ingenuity; perhaps because the device of tax exemption is a two-edged sword, which enhances the marketability of favored securities but reduces the potential efficacy of future revenue acts; perhaps because it smacks of inequality[3] — in a day when federal issues are commonly oversubscribed in spite of narrow exemptions and low interest rates. A recent decision by the Circuit Court of Appeals for the Ninth Circuit, however, that capital gains from sale or redemption of federal land bank bonds are not taxable as income, stands out against this current trend.[4] The court, in reaching its conclusion, which affects the exemption of capital gains on more than a billion dollars of bonds now in private hands,[5] worked through a tangle of statutory interpretation

* Stewart v. United States, 106 F. (2d) 405 (C. C. A. 9th, 1939).

1. Although the Supreme Court has not had occasion during this period to rule explicitly on state taxation of federal bonds, it has displayed an increasing tendency to restrict the implied immunity of federal instrumentalities, sprung from McCulloch v. Maryland, 4 Wheat. 316 (U. S. 1819) to cases where perceptible economic interference is created by state taxation, and has looked sharply to be certain that the Government itself is the party in interest. Compare the Court's reasoning in Gillespie v. Oklahoma, 257 U. S. 501 (1922); Northwestern Ins. Co. v. Wisconsin, 275 U. S. 136 (1927); MacAllen Co. v. Massachusetts, 279 U. S. 620 (1929) with that in Helvering v. Mountain Producers Corp., 303 U. S. 376 (1938); James v. Dravo Contracting Co., 302 U. S. 134 (1937); Fox Film Corp. v. Doyal, 286 U. S. 123 (1932); Educational Films Corp. v. Ward, 282 U. S. 379 (1931). Treatment by the Court of the analogous state immunity has revealed an even more explicit change of attitude. Helvering v. Gerhardt, 304 U. S. 405 (1938).

2. The power of Congress to exempt specified federal bonds from any and all taxation has not been seriously questioned, but ambiguous statutory clauses have been construed to deny exemptions where possible. Lawrence C. Phipps, 34 B.T.A. 641 (1936), *aff'd*, 91 F. (2d) 627 (C. C. A. 10th, 1937); Edgar A. Igleheart, 28 B.T.A. 888 (1933), *aff'd*, 77 F. (2d) 704 (C. C. A. 5th, 1935); Central Hanover Bank & Trust Co. v. United States, 14 F. Supp. 541 (Ct. Cl. 1936); Hamersley v. United States, 16 F. Supp. 768 (Ct. Cl. 1936).

3. Lowndes, *Taxing the Income from Tax-Exempt Securities* (1938) 32 ILL. L. REV. 643, and Shultz, *Tax Exemption of Governmental Securities* (1939) 17 TAX MAG. 331, are interesting discussions of the economic and social issues involved.

4. Stewart v. United States, 106 F. (2d) 405 (C. C. A. 9th, 1939). The Board of Tax Appeals five months before this decision denied Stewart's contention in a similar case which was not appealed to the Circuit Court nor mentioned in its opinion. Agricultural Securities Corp. *et al.*, 39 B.T.A. No. 157, May 25, 1939.

5. On December 31, 1937, the value of bonds outstanding was $1,867,232,080, of which $862,329,840-worth was held by the Farm Credit Administration. MOODY'S MANUAL OF INVESTMENTS (1938) 2282. No estimate of the amount of capital gains currently being realized by dealings in these bonds is available. The volume, however, has been great enough to engage Congressional attention. See *infra* note 6.

unaided by a single precedent even remotely in point, since the exempting phrase in question had never been construed in its 23 years of existence.

From 1916 to 1938, bonds of federal land banks were issued under a statute which exempted bonds "and the income derived therefrom" from federal, state, municipal and local taxation.[6] Until 1932 no effort was made to levy income tax on capital gains which arose from sales of the bonds.[7] Beginning with an order of 1932, however, the Commissioner of Internal Revenue required income tax payments on such gains in the hands of private owners.[8] The order was issued in the absence of any judicial construction of the exempting phrase, but was the product of reasoning employed by the Supreme Court in *Willcutts v. Bunn*,[9] a case dealing solely with the constitutionality of a tax on capital gains. As developed in the principal case, the Government took the position that capital gains, generally, are derived at least in part from a course of dealing in the market, in contrast, for example, to the derivation of interest payments, which may be said to accrue by reason of passive ownership alone. This view of the nature of capital gains is set forth in the *Bunn* case, where its determination was an essential one to support the decision reached: that a tax on capital gains realized in the sale of municipal bonds is not a tax on ownership of the bonds but one on the act of sale. If, in the *Bunn* case, capital gains had been regarded as derived from the bonds themselves, the Court apparently felt that the taxing statute would be an unconstitutional burden on the function of state government.[10]

The judicial technique exhibited in *Willcutts v. Bunn* has been a popular one. In a wide variety of situations where taxation seemed apparently prohibited, the courts have with microscopic discrimination shaded a line between

6. 39 STAT. 380 (1916), 12 U. S. C. § 931 (1934). Section 26 reads: ". . . farm loan bonds issued under the provisions of this Act, shall be deemed and held instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation."

An amendment of 1938, 52 STAT. 578, 12 U. S. C. § 931 (a) (1938), effective as to bonds issued after its passage, provides exemption for interest but not for other forms of income. This amendment, apparently, does not remove the exemption of "income derived therefrom" granted by the Farm Loan Act, insofar as it prohibits state, municipal or local taxation.

7. Whether because capital gains were uniformly considered exempt, uniformly taxed, or simply were not an important enough source of income to challenge inquiry does not appear, but published records of the Treasury are barren of any construction of the question. Individual land banks, the Federal Farm Loan Board, and private investment houses issued many circulars advertising that the bonds "and the income derived therefrom" were exempt, but none raised the issue of capital gains. Circular No. 9, issued by the Federal Farm Loan Board under date of May 15, 1918, for example, included the statement: "It will be noted that this exemption is complete, and that in addition to the exemption from State, city, and local taxation, the bonds are free from normal and additional Federal income tax and need not be included in income tax returns."

8. A telegraphic decision of March 8, 1932 instructed the Collector at San Francisco to levy income tax on capital gains from land bank bonds. Stewart v. United States, Record on Appeal, No. 9100 (C. C. A. 9th, 1939) 5.

9. 282 U. S. 216 (1931).

10. See Willcutts v. Bunn, 282 U. S. 216, 227 (1931).

a tax on property and a tax on the privilege of alienation.[11] The exempting clause of the Land Bank Act itself has not been sufficient to bar an estate tax on the privilege of transferring land bank bonds at death.[12] The Commissioner was, therefore, not without authority in regarding income derived from sale or redemption in a category different from that accruing to passive ownership.

However, even in the absence of binding precedent, judicial trends take secondary place in a decision which must depend primarily on a determination of what Congress intended in legislation now two decades old.[13] The *actual* intent of Congress remains, in this instance as in most, conjectural[14] — if not completely fictional.[15] Yet the subsequent legislative history of the exempting clause gives hint of some meaning.

Congress made no change in the clause from 1916 until enactment of an amendment in 1938 which removed the privilege except as to interest on all bonds subsequently issued.[16] Such a change is some evidence of a view in

11. Plummer v. Coler, 178 U. S. 115 (1900); United States Trust Co. of N. Y. v. Comm'r of Int. Rev., 98 F. (2d) 734 (C. C. A. 2d, 1938); Lawrence C. Phipps, 34 B.T.A. 641 (1936), *aff'd*, 91 F. (2d) 627 (C. C. A. 10th, 1937); Hamersley v. United States, 16 F. Supp. 768 (Ct. Cl. 1936); Central Hanover Bank & Trust Co. v. United States, 14 F. Supp. 541 (Ct. Cl. 1936); Hubert de Stuers, 26 B.T.A. 201 (1932). An analogous technique, employed to defeat exemption, is exemplified in Hale v. State Board of Assessment and Review, 302 U. S. 95 (1937), where a state statute exempting bonds "from all taxes" was not sufficient to prohibit state income tax on interest therefrom.

12. Edgar A. Igleheart, 28 B.T.A. 888 (1933), *aff'd*, 77 F. (2d) 704 (C. C. A. 5th, 1935).

13. Puerto Rico v. Shell Co., 302 U. S. 253, 258 (1937).

14. The only specific indication of Congressional intent which the circuit court in the principal case was able to elicit from the Farm Loan Act was the use of the word, "interest" six times in Section 22, which may suggest a broader meaning for "income derived therefrom" in Section 26. Stewart v. United States, 106 F. (2d) 405, 408 (C. C. A. 9th, 1939). However, the somewhat sophisticated view of the origin of capital gains, expressed judicially for the first time 18 years later in the *Bunn* case, without affirmative evidence can hardly be attributed to Congress at the time of enactment. In its absence, the primary meaning of "income derived therefrom" as opposed to "both as to principal and interest"—used the following year in legislation creating Liberty bond exemption, 40 STAT. 35 (1917), 31 U. S. C. § 746 (1934), seems sufficient to include capital gains. In reference to contentions of this kind, the majority in Agricultural Securities Corp. *et al.*, 38 B.T.A. No. 157, May 25, 1939, urged (at p. 5) that the meaning of "income derived therefrom" might be broader than "interest" yet not include capital gains since it would include "dividends, rent, and similar items" which might be paid over to bondholders by a receiver. Almost certainly, however, such payments would be classified as interest; the case cited by the Board does not indicate otherwise.

The bonds were offered for sale above par. N. Y. Times, July 3, 1917, p. 12, col. 7. Original purchasers, therefore, were not in a position to contemplate capital gains and their exemption, it can be argued, was not an important factor in marketability. Yet it does not follow, in the light of the publicity value of "complete" exemption, that the exclusion of capital gains from taxation would have had no reasonable motivation in Congress; nor is it safe to assume that the intention of legislators expressed in exemption statutes is confined to rational calculation.

15. Radin, *Statutory Interpretation* (1930) 43 HARV. L. REV. 863, 870.

16. 52 STAT. 578, 12 U. S. C. § 931 (a) (1938), cited *supra* note 6.

Congress that the exemption of capital gains, now become undesirable, had until the amendment a very real existence. The Congressional committee which framed the amendment seems to have so thought.[17] Moreover, while Congress deleted the contested phrase from the Farm Loan Act, at the same session it exempted bonds issued by the Commodity Credit Corporation "and the income derived therefrom" from all taxation.[18] It is difficult to explain such action except on the hypothesis that Congress meant to grant a different exemption from that of interest only in the Farm Loan Act. And certainly re-enactment makes doubly doubtful any claim that amendment of the Act was made to clarify a previously misunderstood intention rather than to change the status of bonds thenceforward issued. Even after 1932 the Bureau of Internal Revenue itself construed the exempting clause broadly, while contending for a narrow reading. General Counsel for the Bureau ruled in 1933 and 1935 that the disputed words were sufficient to exempt capital gains on deals in land bank bonds by land banks themselves.[19] No statutory basis for

17. The first draft, the Committee explained to the Senate, "subjected to Federal income taxation capital gains realized by a joint stock land bank on obligations issued and mortgages made by it after the date of enactment of the act" 83 CONG. REC. 5174 (1938). In its report the Committee had said: "Under the Federal Farm Loan Act . . . which governs the taxability of obligations of joint stock land banks, such income is exempt. The Committee is of the opinion that such income ought to be taxed." SEN. REP. No. 1567, 75th Cong., 3d Sess. (1938) 47. No mention was made of capital gains in the hands of private investors. An amendment to this first draft was proposed by Senator King of the Finance Committee, "to broaden and amplify the provision" 83 CONG. REC. 4959 (1938). "The effect of the amendment is not only to tax that gain but also to tax gain realized . . . by an individual . . . Thus, gain on a sale of such a joint stock land bank bond by an investor is subject to tax. The amendment continues the present provision of law under which interest on such bonds and mortgages is exempt from Federal taxation" 83 CONG. REC. 5174 (1938).

If Congress believed that the exempting phrase had been correctly construed as to capital gains in the hands of individuals, no reason appears for the second draft, for the first alone would have corrected the Bureau's rulings (cited *infra* note 19) which construed the exemption to apply to capital gains by land banks alone. Nor can it be satisfactorily argued that the second draft was intended to spell out Congressional opinion as to the inclusion or exclusion of capital gains in the phrase "income derived therefrom"; for Congress did not indicate its construction of the phrase, choosing instead to declare only that capital gains, whether derived from the bond or not, would be considered gross income under the revenue acts (see *supra* note 6). So far as the amendment was concerned, capital gains remained exempt from state, local and municipal taxation as income derived from the bond within the Act of 1916. The enlarged amendment is, therefore, explicable only on the ground that Congress believed capital gains in private hands were exempt under the terms of the 1916 Statute and wished to remove that exemption.

18. 52 STAT. 107 (1938).

19. General Counsel's Memorandum 11,726, unpublished. Under date of April 3, 1933, counsel stated, in part, referring to a case involving the Des Moines Joint Stock Land Bank: "Section 26 of the Federal Farm Loan Act specifically exempts Federal land banks and national farm loan associations from Federal, State, municipal and local taxation, except taxes upon real estate held. The exemption specifically applies to the capital and reserve or surplus and 'the income derived therefrom'. The words 'income derived therefrom' as there used have been interpreted by the Bureau to mean any gains or

distinguishing between different classes of owners, so far as the exemption goes, is set forth in the Bureau's memoranda construing the Act. These indications of intent are to some degree offset by the fact that revenue measures from 1921 onward specifically exempted from taxation only interest from land bank bonds, making no mention of other forms of "income derived therefrom."[20] Such an omission is, of course, not sufficient to repeal the previous specific exemption, and it is only some evidence of a lack of Congressional intent to exempt capital gains.[21]

In the face of these indicia of legislative desire, the *Bunn* case becomes a somewhat slender reed upon which to lean.[22] Concerned with an implied constitutional exemption of capital gains on municipal bonds, it has little relevance to construction of a specific statutory exemption in a case where no problem of interference with sovereign power is involved. Language in the opinion, relied on to sustain the Government's claim that capital gains are not derived from the bond, does not go that far. The Supreme Court realistically pointed out that capital gain is the final product of at least three factors, "the creation of capital, industry, and skill,"[23] leaving no doubt that one factor is the bond itself. A literal application of this view to the exempting statute calls at most for segregation of capital gain into taxable and nontaxable proportions, since the operative clause forbids taxation of that portion derived from the bond. The economic absurdity of such a calculation emphasizes the fallacy of applying general language in a remote case to decisions which must be primarily concerned with the meaning of words in a specific context of time and circumstance. Moreover, the status of capital gains in the *Bunn* case, as of 1931, is relevant only so far as it is some evidence of current significance of the term in question, to be weighed in the balance with indications of contemporary Congressional intent. Certainly the inferences

profits derived from dealings in capital and reserve or surplus. In the same paragraph of the same section, farm loan bonds and the 'income derived therefrom' are exempted. It would be inconsistent to define the words 'income derived therefrom' found in the third line of section 26, to include profits or gains, while at the same time defining the same words found in the tenth line of the same section, to include only interest . . . Under such circumstances, it is the opinion of this office that the income so derived, was derived from the bonds as contemplated by the Federal Farm Loan Act." *But see* assertion of counsel for the Bureau in a ruling on the claim advanced in the principal case. Stewart v. United States, Record on Appeal, No. 9100 (C. C. A. 9th, 1939) 106.

20. For example, INT. REV. CODE § 22 (a) and (b) for 1928 defines gross income as "gains, profits, and income derived from . . . sales or dealings in property . . ." and excludes only "interest upon . . . securities issued under provision of the Federal Farm Loan Act . . ." from that definition.

21. The Bureau of Internal Revenue in 1937 ruled that specific language of the Railroad Retirement Act, 49 STAT. 967 (1935), 45 U. S. C. § 2881 (Supp. 1938), which provided that "no annuity shall be . . . subject to any tax . . . under any circumstances whatsoever . . ." was sufficient to exempt such annuities from the income tax, although the Revenue Act [INT. REV. CODE § 22(b)(2)] provided that amounts received as an annuity . . . shall be included in gross income." I. T. 3069, 1937-1 CUM. BULL. 59.

22. The Board of Tax Appeals relied heavily upon it. Agricultural Securities Corp. *et al.*, 39 B.T.A. No. 157, May 25, 1939.

23. 282 U. S. 216, 228 (1931).

to be drawn from *Willcutts v. Bunn* are not in accord with subsequent Congressional wording of the Commodity Credit Act[24] and with the Bureau's own rulings as to the status of capital gains in the hands of land banks,[25] all later in time than the *Bunn* decision.

That tax exemptions of the type in question are in most cases now no longer desirable or necessary for the sale of federal obligations seems well settled. But whether Congress was of such mind in 1916 and again in 1938 is not so clear. In so close a decision as that presented by the principal case, it may well be that questions of policy are legitimately determinate. If so, the climate of judicial opinion in regard to tax-exempt securities, as well as political considerations, must have made the Government's contentions tempting ones to the courts which heard them. Short of giving decisive effect, however, to some such social estimate, the circuit court was in no position to reach any other conclusion than the one at which it arrived.

MUNICIPAL EXPENDITURE IN EXCESS OF CONSTITUTIONAL DEBT LIMITATION*

PRESSURE on cities to spend for relief and public improvement, at a time when revenues are reduced,[1] makes for unbalanced budgets and increased municipal borrowing.[2] In most states this problem is further complicated by the presence of debt limitations.[3] Courts tend to be strict in construing these limitations,[4] and, as a general rule, strike down contracts which overreach the constitutional quota. Yet occasions have arisen, in recent years especially, when judges have been moved by urgent circumstances to seek and find loopholes in constitutional prohibitions.[5]

24. 52 STAT. 107 (1938), cited *supra* note 18.

25. General Counsel's Memorandum, cited *supra* note 19.

* Columbia Insurance Co. v. Board of Education, 91 P. (2d) 736 (Okla. 1939).

1. Municipal income, derived mainly from the property tax, varies in direct proportion to real estate prices. WHAT THE DEPRESSION HAS DONE TO CITIES (Ridley & Nolting eds. 1935); *Muncipal Debt Defaults*, PUB. ADMIN. SERV. No. 33 (1933) 8, 9. Of course, even in years economically normal, a critical shortage of funds may occur through careless budgeting, or tax delinquencies, or an unpredictable expense.

2. HILLHOUSE, MUNICIPAL BONDS (1936) Table XXXIII, 486.

3. Thirty-one states have constitutional debt limits, while there are statutory limits in 13 others. See INSTITUTE OF MUNICIPAL LAW OFFICERS, REP. No. 36 (1938).

4. Smith v. Broderick, 107 Cal. 644, 40 Pac. 1033 (1895); Logansport v. Jordan, 171 Ind. 121, 85 N. E. 959 (1908); Pepper v. Philadelphia, 181 Pa. 566, 37 Atl. 579 (1897).

5. Debt incurred to supply water, light, sewage and recreation areas may be treated as a class of borrowing not controlled by the debt limitations. Allison v. Phoenix, 44 Ariz. 66, 33 P. (2d) 927 (1934). The validity of a loan "within revenue" may be calculated, not by expected income, but by the greatest amount which might constitutionally

Recently the Oklahoma Supreme Court invoked a new doctrine of municipal privilege to enforce a contract in which a municipality had incurred forbidden debt.[6] The case involved the insurance of some school buildings by a policy purchased by a municipality on credit. It is stated in the court's opinion that the contract constituted an "invalid charge against the school district"; but when the school burned, before any premium had been paid, the court gave judgment on the contract against the insurance company.

This case could have been disposed of by the court on grounds of simple contract, in which the promise by the company to insure was enforceable by reason of consideration moving from a party other than the promisee;[7] for by a state statute, any municipal officer contracting to spend beyond his legal allowance is personally subject to suit for the payment promised in behalf of the municipality.[8] That right of action was known to both parties,[9] and when created here for the insurer it was a valid consideration for the promise to indemnify the school district in the event of loss by fire. If the case were treated in this context, no issue of illegal debt need have arisen.

But the court did not think of the matter in these terms. The argument used cited a number of cases in which municipalities were defendants in actions for goods delivered under contracts violating the constitutional prohibition. In these cases the Oklahoma court has held that defendants need not pay the price promised for purchased materials, and yet could, nevertheless, keep the materials.[10] This favored status as defendant, in illegal contract suits, was extended in the principal case to situations in which the municipality is plaintiff, the court holding that promises made to the city are enforceable although the city's promise to pay is invalid. Thus consideration becomes immaterial. In this novel statement of the law, the city takes on a privileged stature, and for this class of cases becomes, somewhat like states, a party able to sue who yet remains beyond reach of suit.[11] The result is, for the

have been raised. Franklin v. Dayton, 269 Ky. 484, 107 S. W. (2d) 338 (1937). Debt which is to be repaid only from a special fund is not included within the limitation provisions. Baker v. Carter, 165 Okla. 116, 25 P. (2d) 747 (1933); Garret v. Swanton, 216 Cal. 220, 13 P. (2d) 725 (1932). A presumption of the validity of a bond issue may overcome a prima facie case of excessive debt. Faught v. Sapulpa, 145 Okla. 164, 292 Pac. 15 (1930). Loans within the year's revenue may be allowed as "anticipating revenue" even though, in fact, repayment from the year's funds is improbable. Eyer v. Old Forge Borough, 309 Pa. 81, 163 Atl. 156 (1932). Delinquent taxes may be anticipated by fundable short term loans even though collection may require legal proceedings beyond the current year. Shuldice v. Pittsburgh, 251 Pa. 28, 95 Atl. 938 (1915).

6. Columbia Ins. Co. v. Board of Education, 91 P. (2d) 736 (Okla. 1939).

7. RESTATEMENT, CONTRACTS (1932) § 75.

8. OKLA. STAT. (Harlow, 1931) § 2509.

9. The court states: "It (the insurance company) assumed said contractual liability with full knowledge of the law and the facts." Columbia Ins. Co. v. Board of Education, 91 P. (2d) 736, 738 (Okla. 1939).

10. Board of McCurtain Cty. v. Western Bank & Office Supply Co., 122 Okla. 244, 254 Pac. 741 (1926) ($22,000 worth of office supplies); J. B. Klein Iron & Foundry Co. v. Board, 178 Okla. 72, 61 P. (2d) 1055 (1936) (bridge materials); Fairbanks-Morse Co. v. Geary, 59 Okla. 22, 157 Pac. 720 (1916) (machinery rented for a year).

11. National Surety Co. v. State Banking Board, 49 Okla. 184, 152 Pac. 389 (1915).

purposes of the debt provisions, that the city may make what contracts it can persuade innocent parties to enter, and enforce them without fulfilling its own promise to pay. A contractor realizes only the frequently worthless right to sue the municipal officers personally.[12]

Assuming the validity of debt-limitation as a basic principle, it would seem that occasionally necessary circumvention could be founded on a less revolutionary theory. One such approach could be made through equitable estoppel. The facts in the instant case indicate that the insurance company knew of the invalidity of their insurance agreement, and yet had taken benefits from it, first by reason of the school board's promise to pay, which probably would have been performed, and secondly through the right of action acquired against the board officers. Had no fire occurred, the insurer was willing and able to collect his premium.[13] It would certainly seem that a participating party, so implicated in a contract, should not be permitted, even though the agreement was still in a purely executory state,[14] to escape liability by arguing that the contract was not lawful.

The estoppel is more securely established by the school board's reliance on the policy.[15] Once assured of this right of indemnity, the officers made no other efforts to protect themselves against loss by fire, although means were at hand. They might have arranged a special election to endorse the loan in question, or have collected the premium money informally. Since the board, in reliance on the insurer's promise, forsook such efforts to protect its investment, the company could not now disclaim responsibility for the loss suffered. Thus a bar would be raised to the defense of illegality; and once the city has paid its premium, the contract would be enforceable without raising the constitutional issue. However, there are patent dangers in the estoppel theory. Although parties contracting with the city are irrevocably committed once the city has consented to an agreement, there would still be no guarantee that taxpayers would not sue to enjoin payment[16] after the city had received benefit. Thus, while estoppel is a handy device to prevent unscrupulous dealers from abusing taxpayers, it would afford no solution to the inequity which permits unscrupulous municipalities to escape fulfillment of their promises by interposing the excuse of constitutional limitation on expenditure.

12. See Board of McCurtain Cty. v. Western Bank & Office Supply Co., 122 Okla. 244, 250, 254 Pac. 741, 745 (1926).

13. The assessment which the board agreed to make was in fact arranged. The company agent had discussed the problem with board officials, and knew both the means to be used, and the likelihood of success.

14. In Hugenot Mills v. Jempson & Co., 68 S. C. 363, 47 S. E. 687 (1903) a corporation sued to enforce a contract made by its ultra vires partnership, and recovered the price of goods not yet delivered because the vendee was estopped from raising the ultra vires issue. A very similar ruling may be made on the theory that the state alone is entitled to raise the ultra vires issue to void a contract. Blair v. Chicago, 201 U. S. 400 (1906).

15. RESTATEMENT, CONTRACTS (1932) § 90.

16. Marlow v. School District, 29 Okla. 304, 116 Pac. 797 (1911); Faught v. Sapulpa, 145 Okla. 164, 292 Pac. 15 (1930).

A second theory of the case could be found in a rule of construction which is applicable both in constitutional and statutory interpretation.[17] Strict prohibitions are sometimes ignored, when enforcement would seriously injure the very interest a provision is intended to protect.[18] This approach to the present case would mean that the court would decline to enforce a constitutional provision designed to relieve taxpayers, because enforcement would injure them by invalidating this insurance contract. The cost of new school buildings being too heavy for the district taxpayers to carry, a contract of indemnity is the reasonable escape from the risk.[19] Because of their harmony with the purpose and spirit of debt limitations, some agreements can be justified by this rule without imposing a harsh burden on dealers.[20] Yet the concept is so narrow that many an eminently desirable contract would still be illegal, because it could not be traced to reduction in the cost load.[21]

Still a third theory of the case is advanced in a few Oklahoma decisions which excuse borrowing beyond legal limits whenever required to carry on essential functions of government.[22] It has been held that a credit quota may be exceeded to pay government officials,[23] or to feed prisoners,[24] or to serve process,[25] because the constitution requires public protection and basic services to continue. It has been suggested by the court that public education is one of the things "absolutely necessary . . . under any humane and modern system

17. The Oklahoma Supreme Court has adopted the principle that its constitution and statutes are equally to be construed in the light of their intended scope. DeHasque v. Atchison, T. & S. F. Ry. Co., 68 Okla. 183, 173 Pac. 73 (1918).

18. Oklahoma Portland Cement Co. v. Pollock, 181 Okla. 266, 73 P. (2d) 427 (1937); similarly in Kirk v. High, 169 Ark. 152, 273 S. W. 389 (1925) the Arkansas court refused to enforce a constitutional mandate against all debt, because that was not intended to apply to the construction of court houses and jails. See also School Dist. of Pontiac v. City of Pontiac, 262 Mich. 338, 247 N. W. 474 (1933).

19. A trustee, faced with the possibility of a heavy loss, may, without specific instruction, indemnify against such loss and charge the trust funds for this purpose. RESTATEMENT, TRUSTS (1935) §176; Stamford Trust Co. v. Mack, 91 Conn. 620, 101 Atl. 235 (1917). The public official in charge of public property is frequently analogized to the trustee. Andrews v. Pratt, 44 Cal. 309 (1872); Topeka v. Stahl, 86 Kan. 681, 121 Pac. 910 (1912).

20. In Logansport v. Dykeman, 116 Ind. 15, 17 N. E. 587 (1888), this theory was used in permitting a contract to hire lawyers or other agents to contest the validity of city debt or to secure its reduction, although initially it involved added expense.

21. J. B. Klein Iron & Foundry Co. v. Board of Comm'rs, 172 Okla. 72, 46 P. (2d) 340 (1936) (replacement of a washed out bridge); Fairbanks-Morse Co. v. City of Geary, 59 Okla. 22, 157 Pac. 720 (1916) (water equipment); Board of McCurtain Cty. v. Western Bank & Office Supply Co., 122 Okla. 244, 254 Pac. 741 (1926) (courthouse furnishings).

22. Hume v. Wyand, 68 Okla. 261, 173 Pac. 813 (1918); Pilling v. Everett, 67 Wash. 109, 120 Pac. 873 (1912). In some states a doctrine of emergency justification for municipal expenditure exists. Snyder v. Hylan, 105 Misc. 78, 173 N. Y. S. 366 (1918); Philadelphia & Reading Coal & Iron Co. v. Directors of Poor, 311 Pa. 236, 166 Atl. 772 (1933).

23. *In re* Application of State to Issue Bonds, 33 Okla. 797, 127 Pac. 1065 (1912).

24. Smart, Sheriff v. Board of Craig County, 67 Okla. 141, 169 Pac. 1101 (1917).

25. Anderson v. Board of Pittsburgh Cty., 134 Okla. 299, 273 Pac. 222 (1928).

of government."[26] If the principle were so extended, the field of education would present certain inherent costs which would obligate the municipal treasury, even though in excess of the budget. Among these, the preservation of educational equipment could be included; and it would be permissible for officers to insure such property when prudent to do so.[27] It is a theory sufficiently limited to prevent abuse, in that only reasonably necessary expenses are permitted, and those only in certain fields of service which can be called essential. Yet the rule adds a flexibility to the debt limit which permits enforcement of contracts when crisis or accident compels unbudgeted action by the municipality; and agreements in this guise would work no hardship on the dealers involved.

In the light of the recurring need for overstepping municipal debt margins, which courts seem compelled to permit, it would appear inequitable to adopt a theory like municipal privilege as used in the principal case, or the suggested contract rationale, which would allow a dealer to recover only against the city officers. These doctrines divert the cost burden of approved public policy to a few private purses. In the alternative, estoppel offers only partial security to dealers, while a constitutional construction which allows economical contracts permits too few exceptions. A more complete solution lies in the concept which permits courts to endorse whatever expenditure the essential functions of government require.

26. *In re* Application of State to Issue Bonds, 33 Okla. 797, 801, 127 Pac. 1065, 1066 (1912).

27. See note 19 *supra*.